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# **AN ASSESSMENT OF THE POLITICAL WILL FOR OIL AND GAS PRIVATISATION IN IRAN**

**Reza Molavi**

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**A thesis submitted in partial fulfilment of the requirements of  
Durham University, Faculty of Social Sciences,  
School of Government and International Affairs,  
for the degree of  
Doctor of Philosophy**

**April 2007**



**18 APR 2008**

## **ABSTRACT**

This study explores issues surrounding the potential for the privatisation of some of Iran's national institutions. In particular, it addresses the issue of what the determinants of the Iranian policy of privatisation are, in order to ascertain whether there is the political will to privatise the Iranian oil and gas industry. In order to answer this question, this study takes a three-pronged approach which relies on multiple methodologies. It begins by providing a theoretical basis for the determination of privatisation policy. Subsequently, it explores a set of international precedents that bind the possibilities of privatisation policy. It then presents an historical outlook on Iran since World War II in order to build a context for the determinants of privatisation policy in Iran. This historical analysis is based on a political economy framework. Finally, the specific background, legal and institutional framework, and policy-maker perspectives are incorporated into the overall analysis. In this final section, particular attention is paid to the views of Iranian policy-makers that have been gained through personal interviews and questionnaires. Together, these three approaches provide a cumulative understanding of the determinants of privatisation policy in Iran. Based on this general assessment, the study makes specific appraisals of the political will of Iranian policy-makers to privatise the oil and gas industry.

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# CHAPTER 1: INTRODUCTION

## **PART ONE: Introduction**

### **1.1 Overview and Impetus for This Study**

This study explores the issues surrounding the privatisation of some of Iran's national institutions. In particular, it focuses on the oil and gas industry. The aim of the study is to understand some of the reasons for an apparent reluctance within Iran's public and private sectors towards privatisation through a determination of the factors influencing privatisation policy-making in Iran.

There is significant impetus for this study at the moment, coming from the domestic situation in Iran. The Iranian privatisation programme began in 1995. Privatisation policies are currently being contemplated or being carried out in the Gulf region. From the author's personal knowledge, the concept is also high on Iran's political agenda. However, its origins, reasons for popularity, requirements, management, social and economic consequences are not that well understood in Iran.

Furthermore, the recent election of Mahmoud Ahmadinejad may have changed the calculations concerning the potential for privatisation in Iran. Therefore, it is valuable to understand the context of any decisions that Ahmadinejad might make. Thus, given the current political climate in Iran and the socio-economic crossroads at which the country finds itself, the author undertook an investigation into the privatisation of the oil and gas industry in Iran as a means of providing a basis for understanding these crossroads.

This impetus also comes from external changes. From President Bush's statements at the Red Sea Summit in June 2003 and the recent political developments within the Middle East, it is not hard to accept the notion that by 2013 the entire Middle East region is poised to become a 'Free Trade Zone' (CNN, 2003). To achieve this



aspiration, it has been suggested that the countries of the region will have to embrace market economy concepts and agree to move towards transparency and 'privatisation', a word often used synonymously with the sale of assets, deregulation and decentralisation.

Furthermore, there is a dearth of understanding concerning the relationship between Iranian politics, society, economics and privatisation. For instance, whilst the term 'privatisation' is currently popular in the region, and in Iran in particular, the consequences of privatisation are rarely thought through. This is especially true as they relate to standards of services, prices, costs, cross-subsidisation, competitiveness, re-allocation of human resources, safety and other components linked to the public interest, as well as to implications for the private sector and existing government organisations. From this investigation, the author will consider the problems that the Iranian oil and gas sectors face in adopting a privatisation model, and what solutions might be found to fit the unique circumstances in Iran. Thus, the study will also review existing literature to establish the void in available research on Iranian privatisation plans in general, and on the Iranian oil and gas industry in particular (see Appendix VIII).

## **1.2 Context to the Study**

This study is not taking place in a vacuum. There is a wide-ranging context to privatisation in Iran. On one level there is an ongoing and extremely long-term debate concerning privatisation in theory. On another level, there is an historical background which must be taken into account. Finally, there is a longer-term history in which this privatisation argument in Iran is only the latest example of deeper historical structures.



### 1.2.1 *Privatisation Debate*

Privatisation has a long history of debate, and this history should be taken into account in an analysis of Iranian privatisation. Whilst the answer to the question “Why consider privatising?” is as old as the subjects of economics and management themselves, there still exist many ambiguities.

In every great monarchy in Europe the sale of the crown lands would produce a very large sum of money, which, if applied to the payment of the public debts, would deliver from mortgage a much greater revenue than any which those lands have ever afforded to the crown... when the crown lands had become private property, they would, in the course of a few years, become well improved and well cultivated (Smith, 1904:348).

This positive slant on private ownership and the view of privatisation has not gone uncontested by Marxist critiques of private ownership. However, in the main, and in many contexts, the basic aims are claimed to be the promotion of competition and increase of efficiency. To achieve these goals, Iran’s former Deputy Minister of Economy, Dr Mohammad Khazaee (2003), stated that maximum efficiency would be achieved if the decision-making politicians and public servants were replaced by market mechanisms, and that the philosophy and practice of the private sector should be injected into the public sector.

The strategy to privatise will require the size of the public sector organisation to be reduced, and public sector borrowing to be controlled and reduced in order to leave room for unfettered private sector borrowing. Privatisation is commonly believed by its proponents to produce transparency of decision-making. Furthermore, because the capital markets are likely to be a surer source of funding than the politically controlled capital markets, over a period of time privatised companies should be able to raise funds to finance efficiency or expansion in a more flexible manner, to meet their special

needs. Financial markets, in turn, bring their own scrutiny by analysts and bankers, a scrutiny and discipline not available in government (Pesaran, 2003).

Keynesian economists would criticise the argument that the assets of enterprises are undervalued because of government fears that sales will not be finalised. Potential conflict of interest with the appointed consultants in the programme is cited as another difficult aspect (Wiltshire, 1987). The main criticisms of the British privatisation programme, for instance, have been in five major spheres (Wiltshire, 1987):

- 1) the failure of the government to ensure competition in industries where privatisation occurs, thereby appearing to convert public monopolies<sup>1</sup> into private monopolies;
- 2) the creation of inadequate regulatory frameworks in such monopolistic or oligopolistic industries, especially in relation to the fulfilment of social obligations on the part of privatised industries;
- 3) failure on the part of the government to adequately safeguard national interests from foreign influences in the privatisation drive;
- 4) selling the 'family silver' – the argument that revenue from sales of public assets should not be apportioned to consolidated revenue but should be earmarked for future generations and future public uses; and
- 5) the standard of services after sale or contracting out.

The question arises of whether the government of Iran would find the courage to divest itself of the control it now exercises over the National Iranian Oil Company (NIOC).

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<sup>1</sup> One might also refer to them as 'regulated monopolies', such as the utility companies in the U.S.

Furthermore, can it successfully re-allocate excess human resources when it is downsized?

Differences in behaviour under state and private ownership may be compounded by differences in objectives. In the private sector, although profit may not always be rigorously and consistently pursued, there is, nevertheless, a clear bottom line. If losses continue to be made, the firm will ultimately fail. In the state sector, however, objectives are vague and tend to change according to the political climate, leading to uncertainty about long-term strategies within industries (Martin and Parker, 1997).

In conclusion, it is widely believed that public ownership reduces the incentive to secure profits and removes the threat of bankruptcy. Private ownership would undoubtedly provide a significant spur to managerial efficiency. Capital would be allocated according to the market, rather than politics, and considerations and interventions would largely cease. To secure such advantages, Enoch Powell and Milton Friedman advocated immediate and wholesale denationalisation (Beesley and Littlechild, 1989).

### **1.2.2 Background**

To analyse the relevance of the privatisation of the National Iranian Oil Company, and to understand the idiosyncrasies and hesitation of the Iranian policy-makers, one must look into its immediate background. The following section briefly illustrates this background.

Most oil-rich Third World economies have had difficulty in evolving into true liberal societies. By owning or controlling revenues generated by oil, the state is able to dominate society, making all classes and groups economically dependent on their 'black

gold'. Oil tends to centralise state power in the Middle East, as this commodity forms anywhere from 80% to 93% of their foreign exchange earnings (USEIA, 1998, 2005).

When the US-backed Pahlavi regime began to fall apart, problems within Iranian society began to compound with the diplomatic pressures being applied by the US, its main ally. To make matters worse, the decline of oil prices in 1974 sharply curtailed its economic ambitions (Kamrava, 1990).

A quarter of a century after the fall of the Shah of Iran and the establishment of an Islamic regime, Iran is re-examining its revolution. The 1979 revolt was originally grounded in a fight for democracy, civil rights and freedom from foreign interference. But the revolutionary process was soon dominated by Ayatollah Khomeini and a coterie of clerical activists, who imposed strict Islamic dress on women and banned alcohol and music. The seizure of the American Embassy and extremely brutal repression of opponents turned Iran into a pariah state.

President Mohammad Khatami tried to restore normality, both in Iran and in its relationships with foreign countries. Elected with 69% of the vote in the May 1997 elections, and again, with some 60% of the vote, in the 2001 elections, he certainly had the mandate of Iran's youthful population. More than 40% of the country's 65 million citizens are under the age of 15.

The job market is tight and, with the introduction of the United Nations' second set of sanctions which is now being considered, trading and imports of desperately needed spares for the ageing oil and gas industry will become much harder. Having the second largest bank in Iran, Bank Sepah, now on the sanctions list, will compound the problems of transacting with the sources of supply in U.S. dollars. Even if the tightening of the noose around the financial institutions does not make it impossible to secure the

requirements of the country from abroad, it certainly makes it uneconomic to buy goods and services from the traditional sources of supply.

The economy is in serious crisis. Iran's population has doubled since the revolution, dramatically increasing consumption. With no growth in the output of the economy (GDP), the standard of living has halved. Half the population, including 70% of government employees, live below the official poverty line. Many have more than one job just to make ends meet. Unemployment is estimated to be 25% and the future seems bleak. Every year, 800,000 young people enter the job market. It is estimated that more than \$100 billion needs to be invested to maintain current employment levels, but only \$2.3 billion is currently allocated to job creation (Reuters, 1998a).

In 1998, fuel subsidies alone reached \$11 billion per year - double the country's development budget. Food subsidies on basic commodities such as bread, rice and sugar consume another \$2.2 billion per year. Together, these subsidies used up virtually all of the country's \$16 billion oil income for the year (Reuters, 1998b). President Khatami accepted market reform and, with no other source of capital available to the country, advocated attracting foreign investments. The President skilfully combined cuts with subsidies, the privatisation of state firms and changes to labour laws - in short, 'shock therapy' to the market, with calls for the liberalisation of social and political rules to allow freedom of expression, freedom of the press and the establishment of a 'civil society'.

President Khatami became fully committed to restructuring the economy. His government approved the privatisation of 538 state-owned companies through auctions and stock sales, with plans to privatise another 2,000 (Reuters, 1999). The Iranian Parliament (*Majlis*) approved plans to overhaul the oil industry and boost Iran's sagging oil production from 3.5 million bpd (barrels per day) to 6 million bpd over the next 10

years (USEIA, 1998). This will require at least \$120 billion in capital, which has to come from private investors and foreign sources.

Through a strategic development plan and the implementation of various petrochemical projects, efforts were underway to raise the production level of Iran's petrochemical industry. Begun in 1997, the plan was divided into five phases, lasting until 2013. By the end of this period, the total volume of final products is estimated to be 16.8 million metric tons per year. The value of investment will amount to \$20.6 billion, with total sales topping \$11.8 billion (PIIC, 2000).

Participation by the private sector, whether in the form of investment or in launching new projects, can have a considerable impact, and it was for this purpose that the Petrochemical Industries Investment Company (PIIC) was established. As privatisation became one of the main policies of the government, it led to the restructuring of the National Petrochemical Company (NPC), with plants having a capacity of less than 100,000 tons per annum being subject to transfer to the private sector (PIIC, 2000). The private sector was also allowed to invest in medium-sized petrochemical plants. NPC offered bonds for the construction of petrochemical plants, and also supplied raw materials to the private sector at a 30% discount compared with world prices.

Sustainability of macro-economic stability and progress in the key area of economic policy reform is critical for placing Iran on a maintainable growth path, announced HE Tahmaseb Mazaheri, the former Minister of Economy, after a meeting with his UK counterpart, Gordon Brown, at the end of June 2003. To obtain an improved private sector environment, financial sector and pricing system reforms, Iran must rid itself of the notion that foreign investors are imperialistic. Although the Ministry of Energy authorised the sale of 14% of the capacity of its state-owned power plants (Utilipoint, 2004), NIOC remains off-limits. This study investigates whether Iran has any choice but

to privatise NIOC, whilst taking into account reasons for the reluctance on the part of the people and the government of Iran.

Since the announcement of the privatisation programme in the Five-Year Development Plan (FYDP) in 2000 (Privatisation Organisation, 2002), significant progress has been made and a new agency set up by the Ministry of Finance. The *Majlis* has promulgated regulations governing privatisation. The Privatisation Committee, under the supervision of the President, reviewed 1,039 public sector enterprises for privatisation: 217 are to remain public, 87 will be liquidated and 735 destined for privatisation. During 2000-2001, the government sold RIs2,040 billion (Rials) (about 0.5% of GDP) worth of shares in public enterprises on the Tehran Stock Exchange (TSE). It ceded RIs100 billion worth of shares to workers. RIs1,800 billion worth of shares are being placed for sale in the current year. In the oil sector, the Oil Ministry announced that it will cede 23 subsidiary firms to the private sector over the FYDP, including the National Iranian Tanker Company (NITC) and the Liquefied Gas Distribution Centres (LGDC) (World Bank, 2001).

The critical issue facing Iran today is its nuclear stand-off with the international community. While this point is self-evident, what is not so obvious is that the eventual resolution of this crisis is likely to profoundly affect Iran in the future, not just in terms of its economy and within that its privatisation policies, but also in terms of its foreign policy, domestic politics and, potentially, even the nature of the state itself.

Iran's economy is in desperate need of reform. When Mahmoud Ahmadinejad was elected President of the Islamic Republic of Iran in June 2005, he came to power on the back of an anti-corruption campaign and his promise to reform the economy, proclaiming that he would bring the oil money to each Iranian's table. In November 2005, President Ahmadinejad announced that the government would begin to distribute shares of Iranian publicly-held industries to the entire populous. Rumours quickly

spread that this was a preliminary step to the seizure and redistribution of many private industries and other assets, and the result was a vast, sudden flight of capital out of Iran, possibly in the order of US\$200 billion. This, together with Ahmadinejad's call to wipe Israel off the map, caused the Tehran stock market to collapse.

Almost 40% of the Iranian GDP is accounted for by the Bonyads, who are nominally charitable foundations established to administer the Pahlavi regime's assets on behalf of the Iranian people, but in actuality are massive corrupt machines that bankroll the senior leadership. The problems with corruption have reduced liquidity, frightened off investment, boosted inflation, spurred widespread unemployment, diminished non-oil exports, impoverished the middle class, and created a very serious gap between the rich and poor. Iran's latest five year plan (Privatisation Organisation, 2004) calls for US\$20 billion investment each and every year, in addition to the US\$70 billion to recapitalise Iran's decrepit oil industry.

According to Amini (2004) and expounded further by Nili *et al.* (2004), Iran's problem is that there are only three capital markets in the world capable of generating such levels of investment within Iran over the next five to ten years - these being the US, Europe and Japan. Much as Iranian hardliners would like to believe that the Russians, Chinese and Indians could substitute for the West, the fact of the matter is that they will not be in a position to do so for about a decade. In addition, there is the issue of superior Western technology: the Iranians would much prefer to have Exxon or Shell repairing the oil infrastructure, rather than Lukoil or Sinopec (Pollack, 2006).

Iran has recently issued an executive order for the privatisation of 80% of several state-owned companies, but retained firm control over the upstream oil sector and key banks (Roshanzamir, 2006). Ayatollah Seyed Ali Khamenei, Supreme Leader of the Islamic Republic of Iran, said in his order that:



...ceding 80 per cent of the shares of large companies will serve to bring about economic development, social justice and the elimination of poverty (Roshanzamir, 2006).

This decree is in an effort to revive Iran's stalled privatisation programme and kick-start the country's many uncompetitive industries of the Bonyad Mostazafan, which are heavily protected and are the root cause of corruption and ill-feeling among the various sectors of society.

By putting this action plan (Privatisation Organisation, 2004) into practice, the government's role will change from direct involvement in ownership and running the large companies to supervising and guiding different sectors of the economy to meet the regulations of the World Trade Organisation. Ayatollah Khamenei has said that the privatisation process will help reinforce the private sector in the national economy and encourage companies to compete in international markets. He continued that the downstream oil and gas sectors would be privatised, but excluded the upstream oil and gas industry, NIOC, the state companies involved in exploration and the production of crude oil and gas.

The former head of Tehran's Chamber of Commerce, Mohamad Reza Behzadian, notes that the move amounts to a major change in the old constitutional attitude toward the economy as the absolute property of the government, stating that this order means a change in the government's role from an owner into a guide (AFP, 2006).

In early March 2007, the bitter rivalry between Iran's President, Mahmoud Ahmadinejad, and the country's leading elder statesman, Ayatollah Hashemi Rafsanjani, erupted into a public struggle for control over economic policies. Hashemi Rafsanjani, the President's most influential opponent, set the scene for a power struggle by telling Iranian journalists on 7 March 2007 that Mr Ahmadinejad's "trial period is over". He said he would use his position as head of the Expediency Council (a state body

empowered to set the Islamic regime's long-term goals) to reshape the government's economic policies.<sup>2</sup> It is rather obvious that whilst there is unanimity and abundance of political will in carrying out the plans on economic reforms, particularly the privatisation programme, there are no signs of universal acceptance on how the political reforms should be in step with the economic liberalisation plans. I will end this section by simply quoting what Mr. Rafsanjani mentioned in his declarations to the press on 7 March 2007.

Now the trial period is over and the supervising role of the expediency council should be enacted more seriously. Under the 20-year outlook plan the country's reliance on oil should be reduced by more than 10% each year but during the last two years this process has been reversed. Next year's budget depends on oil to an even greater extent than those of the last two years.

### **1.3 Research Question**

The previous section has illustrated the impetus for this study, the background and history leading up to it, and the aims and objectives of the study. As we have seen, given the need for a study such as this, to date, no published research on the privatisation of the oil and gas industry has been conducted outside Iran. This study aims to fill this gap and provide future researchers with the empirical data collected by the author during personal interviews and by reviewing existing archives in Iran.

We are now in a position to outline the question which this study will specifically address. This study examines what the determinants of the Iranian policy of privatisation are, in order to answer the question of whether there is the political will to

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<sup>2</sup> Robert Tait in Tehran, Wednesday 7 March 2007, *The Guardian*.

privatise the Iranian oil and gas industry. In order to answer this question, it is necessary to address certain sub-questions. These include:

- The context of theoretical and preceding privatisation policies, including:
  - contemporary privatisation theory;
  - other similar attempts at privatisation, i.e. privatisation in comparable political, economic and social environments.
- How the historical evolution of Iranian politics and economics affected the current policy-making environment.
- What the structural features of importance are, including previous privatisation deals; legal framework; political, social and economic environment; regional and global geopolitical and economic factors.

Furthermore, certain areas of knowledge will have to be addressed in relation to the answer to this thesis question. These areas include:

- The Iranian domestic environment, including:
  - past policy evolution;
    - domestic policy
    - economic policy
    - oil policy.
  - the social psychology of Iranian the government and society;
    - the role of revolutionary ideology
    - the role of religion.
- The external/international environment, including:

- relations with Middle Eastern states;
- relations with the West;
- relations with international organisations.

These sub-questions and issues will all be addressed in this study. The following section will illustrate the argument that will be used to answer the thesis question and address these issues. It will summarise the chapters, as well as the research methodology to be used. From it, the reader will see the framework which will be carried out in this study.

#### **1.4 Summary of Methodology and Argument**

This study will take a three-pronged approach, which relies on multiple methodologies. It will use an historical view of Iran since World War II to build a context for the determinants of privatisation policy in Iran. In particular, this analysis will be based on a political economy framework for analysis. A theoretical basis for the determination of privatisation policy will be developed and the precedents which bind the possibilities of privatisation policy will be explored. Finally, the specific background, legal and institutional framework and policy-maker perspectives will be incorporated. Together, these three approaches will provide a cumulative understanding of the determinants of privatisation policy in Iran. The following section will introduce and examine each approach in more detail.

#### **1.4.1 *Part Two - Theoretical and Precedent-Based Context and Determinants***

Along with these historical and political economic determinants, there are some theoretical determinants of Iranian privatisation policy. Part Two (from section 1.5) presents an overview of the theoretical basis behind privatisation in general. It details the various schools of thought concerned with privatisation. In this way, the central question of this study is addressed in that we detail the realm of possibility that privatisation can be conceived for Iran.

Furthermore, in order to illustrate this realm of possibility, these sections then look at some other examples of privatisation. In particular, they address privatisation in countries surrounding Iran including Pakistan, Azerbaijan, Kyrgyzstan and India. They also look at the non-neighbouring states of Egypt and China which have a major effect on the Iranian economy and the realm of privatisation in general. This helps to refine this study's question by developing our understanding of what the realm of possibilities are for Iranian privatisation.

In other words, Part Two examines the possible privatisation decisions which can be made by the Iranian policy-makers. This is the case because we must assume that as rational actors, Iranian policy-makers and the world's policy-makers who interact with Iranian privatisation policy-makers, can only make decisions based on historical or comparative precedents. Thus, this sets the stage for all possibilities of privatisation and in that sense provides a determinant of privatisation.

#### **1.4.2 *Chapters 2, 3 and 4 – Historical, Political Economy Context and Determinants***

Chapters 2, 3 and 4 employ a political economy approach to analyse the history leading up to present discussions of Iranian oil and gas privatisation. Each chapter explores an

era of Iran, beginning in Chapter 2 with the post-war period, dominated by the Shah, which led to the 1979 revolution. Chapter 3 then addresses the period roughly equal to Khomeini's rule from 1979 to 1989. Lastly, Chapter 4 addresses the contemporary Iranian situation, beginning in 1989 and leading up to the present.

Each of these chapters explores political issues, including domestic and international politics. They also explore economic issues, including changes in the economic outlook of each era, issues affecting privatisation and the international economic situation. The chapters then analyse the interplay between these factors.

Throughout this study, the political economy methodology is utilised. This methodology admits the causality of economic change by political change and vice versa. Thus, it involves examining political issues and noting their economic consequences, then examining economic issues and noting their political consequences.

This study also incorporates domestic and international politics, assuming that domestic factors will have international consequences and that international factors will have domestic consequences. In the case of Iran, we have seen that as the price of oil increases, due to international events and demands, the privatisation fever is dampened, but as the prices drop the popularity of privatisation increases in the country among the political elite.

The culmination of these chapters presents us with a single, evolutionary history of Iran. It brings us to a level of understanding in which economic and political issues can be seen in relation to each other. This will allow us to couch our answer to the central question of this study – i.e. what are the determinants of the Iranian policy of privatisation (with a particular emphasis on the oil sector)?

Furthermore, these chapters partially answer the thesis question. It will be demonstrated that an interplay of domestic and international political and economic factors have been determinants of the Iranian policy of privatisation. Each of these four factors is then explored separately.

The first factor is the disjunction between Iran's government and society. This issue is theorised as what Katouzian (2000; 2003) has called the 'theory of arbitrary rule'. This disjunction between society and the state is illustrated as a factor in pre-revolution Iran. It is then shown to continue into post-revolution Iran, though in a different form, up until the present. Such disjunction between the state and society is the first determinate of policy, and privatisation policy more specifically.

The second factor is the disjunction between economic and political/social modernisation. This disjunction is also examined in relation to the Shah's attempts at economic and political reform. This factor also continued past the revolution and the issue is explored the section on post-revolution Iran.

The third factor in determining policy is Iran's dependence on oil. Oil played a major factor in the Shah's Iran and has continued to do so since the revolution. It has skewed and biased both domestic and international policy in the state and, as will be demonstrated, still plays a huge role in determining privatisation policy.

The fourth factor to consider is the relationship of Iran with the West (the US in particular) and Iranian society's perception of these relations. In particular, its perception of the West's imperialistic attitude towards Iran had significant effects on the nature of Iran's policy before the revolution and has continued to do so after the revolution.

These four factors have all helped to determine the nature of Iranian policy with regard to privatisation throughout the history of Iran, going back at least to the Shah. These factors continued into post-revolution Iran due, in part, to the brevity of the Iranian revolution. Beyond these factors, there are two supplementary factors which have had a significant influence since the revolution. These factors are related to earlier factors, and in some sense existed before the revolution, but became much more important after the revolution.

One supplementary post-revolution factor is the role of the Islamic Republic's revolutionary ideology. After the revolution, politics and economics in Iran had some continuities with pre-revolution Iran, which will be discussed, but also there were huge changes. The revolutionary ideology led to changes in the government, including factionalisation, as well as changes in foreign policy. These included, specifically, the Iran hostage crisis, and Iran's handling of the Iran-Iraq War and the Gulf War. Another key issue has been the Iranian relationship with nuclear power and nuclear weapons. Together, these factors have, broadly speaking, contributed to policy in Iran and, more specifically, to privatisation policy.

The other post-revolution factor is the role of religion in Iran. In particular, religion has had a complex and very direct relationship with privatisation in Iran, and this is explored in some detail. However, it has also had other effects on politics and economics in Iran, such as the complex relationship of Khomeini's views on the revolution with his views on fundamentalist Islam, which also have had indirect, though no less wide-ranging, effects on Iranian privatisation policy.



### **1.4.3 Chapter 5 - Specific Determinants of Iranian Privatisation Policy**

With a theoretical and historical context in place, it is then possible to specifically address the thesis question, being in a position to directly address the specific determinants of Iranian privatisation policy. Chapter 5 focuses on the four primary factors which directly affect privatisation policy. These are the specific background of privatisation thought in Iran; the legal and institutional framework; the nature of oil and gas relative to privatisation in Iran; and the thoughts of relevant policy-makers. These sections pull together all of the historical and theoretical contexts and determinants of Iranian privatisation policy.

The first point to be addressed is the specific background of privatisation in Iran. This section builds on the historical, political economy sections previous to this chapter. It focuses upon the specific issues affecting privatisation with a focus not seen in earlier chapters. The concepts it explores are taken for granted, based on the background of the earlier history chapters as well as the theoretical chapters.

The second point is the legal and institutional framework. This section is based on a close reading of the relevant legal documents concerning privatisation post-1990 in Iran. It will also explore the institutional issues which have arisen since that time and which constrain policy decisions. This section brings together both the theoretical factors of privatisation, discussed in Part Two of Chapter 1, as well as the legal and political evolution discussed in Chapters 2, 3 and 4. The third point is that the oil and gas sector is unique in Iran and needs to be addressed separately from different types of privatisation. This section directly addresses the contemporary determinants of Iranian oil and gas privatisation. It is based on the political economic issues concerning oil and gas in Iran which are covered in Chapters 2, 3 and 4. It also brings into play supplementary information towards understanding this sector. Together, this provides a specific understanding of oil and gas sector privatisation in Iran.

Finally, this chapter also presents primary research on the personal views of relevant decision-makers in Iran who are concerned with privatisation. This primary research is based on extensive interviewing with relevant sources. Firstly, the interview questions have been methodologically explored in order to provide a perspective on what kind of information is relevant and what sort of biases can be expected, in order to provide us with a view of what to expect. The results of the interviews are then described and examined.

#### **1.4.4 Chapter 6 - Conclusions and Implications**

Chapter 6 summarises the conclusions of each chapter and brings out the implications of the study. The factors determining privatisation policy, particularly those with regard to the oil and gas sector in Iran, are then illustrated in Chapter 6 (Table 6.1). These factors all interact to determine the privatisation policy in Iran. Each plays its own role and must be taken into account separately. As seen in Chapter 5, the contextual factors all contribute to the specific factors which will determine privatisation.

Thus, we are able to conclude that the answer to the thesis question posed is this: privatisation policy in Iran will be determined by several interacting factors including the disjunction between state and society, the disjunction between economic and political/social modernisation, Iran's economic dependence on oil, relations and perceptions of relations between Iran and the West (in particular the US), the Islamic revolutionary ideology and religion, as well as through theories of privatisation and international precedents of privatisation.

This conclusion allows us to take away some implications from the study. Specifically, we are able to make some hypotheses concerning the political, economic, oil and gas

privatisation prospects for Iran. The framework developed in this study allows us to do more than simply make guesses at these prospects. It enables us to operationalise specifically defined determinants of policy in Iran.

#### **1.4.5 *Note on Research Methodology***

This study uses a dual methodology, based on primary and secondary sources. As illustrated in the summary of chapters above, secondary sources have been combined with publicly available primary source information in order to provide a context for answering the thesis question. This has been combined with new, primary source data collection filtered into the third section of Chapter 5, which focuses upon the personal views of policy actors who are related to the privatisation process. The primary and secondary sources analysed include:

- relevant legal texts;
- government documentation;
- regulatory documentation;
- banking and other business documentation and data;
- government speeches; and
- theoretical and other academic texts and journal articles.

The new, primary source methodology, in essence, uses qualitative methods and ‘snowball’ sampling. The sample is relatively small in size and confined to key personnel of the Ministry of Power and affiliated companies within the oil and gas sector, including the NIOC, NPC, NITC and Helicopter Services Organisation (HSO). Qualitative research methods allow the reader to better understand the nuances involved

in this study and constitute the main difference with studies that have taken place elsewhere.

A questionnaire was designed with national objectives in mind and formed part of the researcher's method of collecting data. Case studies of the concept in other countries were brought to the attention of interviewees, during discussion of the questionnaire.

Data collection can best be dealt with by personal visits and interviews. Having worked as a consultant and provider of services to the sector, the author has had access to decision-makers for personal interviews. The interviews, collection and collating of data for this research facilitated the completion of this study. Analysis of the collected samples and questionnaire used qualitative methods, with the technique for analysis taking the profile of the interviewees into account.

## **PART TWO: Privatisation Theory and Comparison of Precedents**

### **1.5 Introduction**

Part One has given an historical, fact-based background to this study, detailing the political and economic changes in Iran since World War II and through to the contemporary period. It has, in particular, illustrated the interplay of politics and economics at both a domestic and international level in Iran. This was achieved using a political economy methodology which specifically admits the mutual causality of politics and economics.

The following sections will take a wholly different perspective on answering the central question of this thesis. Rather than looking at the background of decision-making, this

chapter will look at the realm of possibility and the precedents to decision-making which are out of the control of Iranian policy-makers. Indeed, this theoretical and precedent base to possible decisions is not determined by any individual actor, but is rather a structural feature of the international system which is determined by the interplay of different actors and by the evolution of ideas, or what Dawkins (1991) has called memes, something which cannot be determined by any given thinker.

Thus, the realm of possibility is that which determines and constrains policy-makers in making and implementing decisions. It includes, specifically, those theoretical possibilities for privatisation. These are determined by the specific theories about privatisation which have been considered by analysts and practitioners, and which could be used as a framework for privatisation in Iran. It is also made up by the precedents set by other states which have attempted to privatise in the past. These states were also constrained by theories about privatisation which existed at the time, precedents available to them while making decisions, along with the circumstances and resource base available.

At the same time, there is an interplay between the possible decisions which Iran can make concerning privatisation and their actual decisions over time. This is a process called structuration, developed by Giddens (1984) to serve as a means of solving the so-called 'agent-structure' problem. The 'problem' is that it is not clear whether structures or systems cause agents to act as they do, or if agents create the structure. Giddens' solution is to say that there is an interplay over time between the structure and agent where each contributes to the formation of the other. In the case of Iranian privatisation, the structuration solution is that theory and precedents (the structure) are informing the decisions of policy-makers in Iran (the agents), and that at the same time their decisions are contributing to the nature of the structure, i.e. by becoming another precedent. The implication is that it is clear that the theory and precedents of privatisation must be studied. In other words, Iranian privatisation is not taking place in a vacuum.

Part Two begins by addressing the theory of privatisation. It starts with a very general overview of the issue, including definitions of important concepts. It then moves on to illustrate and examine the different possible forms of privatisation. From this, the stage is set to take a more in-depth look at some specific issues that arise in privatisation and which have important implications in Iran; in particular, the issue of rights to property are then explored.

In the second section of this study, some relevant privatisations are examined. The section addresses relevant states which surround Iran and ones which are further off but still have a large impact on Iranian privatisation. The countries which are addressed and that are surrounding Iran include: Pakistan, Azerbaijan, Kyrgyzstan and India. The non-neighbouring states which still have a major effect on the Iranian economy and the realm of privatisation in general, are Egypt and China (see section 1.6). The examination of these states begins with an historical look at their privatisation attempts over the last decades. It then moves on to analyse these attempts with regard to the structural constraints they put on other states in their attempts to privatise.

The conclusion summarises the findings. It then provides an analysis of how these theoretical constraints affected Iran and how knowledge of these precedents affected decision-making in Iran. The implications of this analysis are then examined in regard to the central question of this study.

### **1.5.1 *Privatisation and Related Concepts***

The term 'privatisation' implies a wide range of meanings, which transpires in the large number of theoretical and empirical analyses on the subject (Demsetz, 1967; Backhaus, 1989; Barzel, 1989; Bouin, 1992). One particular study, for example, has enumerated as many as fifteen understandings of the concept of privatisation (Gormley, 1991). In more

specific and fundamental terms, it is understood as the transfer of property and control rights over given enterprises, infrastructures and other economic establishments from the state to the private sector. In a wider sense, privatisation is conceptualised as the process of enhancing the effectiveness of the non-state economic sector. Obviously, the latter can both incorporate and exclude the former, and as such could open up possibilities for rhetoric commitment to privatisation on the part of political and economic elites.

On an even wider footing, privatisation can be interpreted as a process which incorporates broad measures of economic liberalisation, such as reducing state paternalism, the removal of bureaucratic obstacles for economic agents and the improvement of the functioning of state-owned enterprises. In this sense, even if privatisation is being implemented in the economic milieu, it represents a *bona fide* political process which requires the researcher to delve deeply into its political determinants and consequences. As such, privatisation clearly differs from other phenomena, signifying a withdrawal of state influence and control over the economy, such as commercialisation, decentralisation and deregulation. They can all exist independently, but can also join into a coherent governmental privatisation strategy.

Commercialisation implies the extraction of state-owned enterprises from the framework of state-planning, i.e. they become independent, economic agents with their own capital and juridical standing that function according to the logic of the market. Decentralisation is defined as the process of transferring ownership and control rights from central to local structures of state authority, whereby state planning acquires a dimension of a mere summary of local economic planning. Finally, deregulation implies the withdrawal of the state from many aspects of the country's economic life through, *inter alia*, the liberalisation of prices, the liberalisation of the trade regime, demonopolisation, etc.

The notion of privatisation should also be distinguished from the closely related, but narrower, concept of divestiture. It presupposes the spin-off of filials, branches or units of a given enterprise, either because of hardship or economic necessity. In the first case, the revenues from the sale would help maintain the rest of the activities; in the second, there is a restructuring or re-orientation predominantly towards other areas of the business. Divestiture can be effected through the transfer of shares or material assets and is often a method of exiting a position of market monopoly, voluntarily or not. Another associated mechanism, which is also short of the transfer of property and control rights over a given enterprise, is that of contracting service providers, such as managerial or consultancy services, and outsourcing certain of its less profitable activities to third parties (Gormley, 1991).

### **1.5.2 *Forms of Privatisation***

The process of privatisation, broadly defined above as the transfer of property and control rights over state-owned enterprises, can take multiple forms. They are all part of this definition and operationalise it from different perspectives and according to different criteria, including scope and method, parties involved, type, size and sector of the privatised enterprise, market share, etc. Table 1.1 provides a concise presentation of the various forms, which are further elaborated below.

The different forms shown in Table 1.1 generate a different focus on the determinants and consequences of privatisation. Each implies a specific configuration of relevant actors, interests and institutional frameworks, which define a particular approach towards its analysis. In terms of its scope, privatisation can be full or partial. The former implies the complete withdrawal of the state from the privatised enterprise, while the latter presupposes the preservation of a certain level of state ownership (usually a minority stake). The latter option is preferred when the industry within which the



enterprise operates is placed under sustained governmental control, as the new enterprise owners are able to ensure a continued interest on the part of the state in its progress. This comes with the price of having to take into account certain economic and social policies that the government undertakes to fulfil.

**Table 1.1: Forms of Privatisation**

<b>Criterion of Distinction</b>	<b>Form of Privatisation</b>			
<b>Scope of privatisation</b>	Full		Partial	
<b>Privatisation method</b>	Public offering of shares	Tender	Negotiations with an investor	
<b>Investor</b>	Foreign	Domestic	Combined	
<b>Seller</b>	Specialised state organ	Governmental ministry	Intermediary	The Enterprise Board
<b>Type of state ownership</b>	Restructured enterprise (ownership of shares)		Non-restructured enterprise (no division in shares)	
<b>Owner</b>	Central government		Local authorities	
<b>Volume of the privatised assets</b>	Large	Medium	Small	
<b>Economic sector</b>	Industrial privatisation	Bank privatisation	Agriculture, services and trade	
<b>Market share of the enterprise</b>	Monopoly		Non-monopoly	

Source: Based upon Pirie (1988) and Vuylsteke (1988).

According to the privatisation method, there are generally three ways of transferring state ownership into private hands. These are the public offering of shares, through

which ownership is dispersed as widely as possible, and tender and negotiation, which suppose a single buyer. This method of negotiation offers most flexibility in terms of being able to field additional proposals following the initial presentation of the standpoints of both the investor and the seller. In terms of investor orientation, privatisation can be aimed at attracting foreign buyers or at stimulating the acquisition of economic assets by domestic companies. Depending on the specific privatisation policy, a combination of these two types of investors in a single joint venture company can also be acceptable to the seller.

With regard to the seller itself, privatisation can be implemented by a specialised state organisation, a governmental ministry, an intermediary or by the Enterprise Board. Among these (in cases of ownership by the central government, and not municipalities), in all three cases, apart from the ministry, there is a lack of overlap between the seller and the new owner which introduces further and interesting dimensions in the analysis of any particular contract. In terms of the type of ownership, broadly, most companies can be owned through their shares; where the state possesses the shares of a company whose structure requires their existence, or it can be owned, as a material object, through their production assets, buildings, etc. Both types imply different privatisation strategies.

The rest of the forms of privatisation are more or less self-explanatory, distinguishing between ownership by the central government and municipal authorities, among large, medium and small privatisations (in cases of large-scale privatisation across the country), among different economic sectors and between a monopoly and non-monopoly market share of the privatised enterprise. An interesting element of privatisation, in cases where the state has acquired property over enterprises through nationalisation without due compensation, is the so-called restitution. If undertaken at all, a policy of restitution has the potential to permeate all of the above forms of

privatisation and generate policy proposals that need to be accounted for in a comprehensive way (Ohashi, 1980).

### **1.5.3 *Right to Property***

The right to property, and its conceptualisation and implementation within any given society, is fundamental to understanding the potential content and orientation of the policy of privatisation pursued by its political and economic elite. It relates to the fundamental dilemma of privatisation which suggests that there is an inherent conflict between the possibility for a state to transfer economic ownership to private companies and the possibility of guaranteeing the continuity of those economic and social policies that it has been implementing, or would like to implement, in the particular sector of privatisation. In a way this is logical (being guided by the stimulus of revenue and profit) as private agents usually give less consideration to the wider economic and social implications of their managerial practice than governments do (Mihaly, 1992).

The different dimensions of the right to property, and their combination and utilisation in privatisation policy, contribute to both exacerbating and alleviating this conflict and the following paragraphs demonstrate how (see also Table 1.2). The basis of property rights was laid down by Roman law. In its understanding they consist of a) the right to use and manage (*usus*); b) the right to revenue (*usus fructus*) and c) the right to sell or exchange; i.e. fully or partially release oneself from property rights against a certain price (*abusus*). In addition to these, a fourth element has also been seen as relevant, particularly with regard to privatisation, and this is the right of residual control over the property. This right is different to the right to use and manage and the right to sell and exchange, and implies control over all decisions regarding the use of the property, which are not explicitly regulated by law or contract (Munzen, 1990).

This fourth dimension of property rights offers a key analytical space for a new way of determining which agent (economic or political) is the owner of a given enterprise. A creditor to a company acquires short-term rights to revenue arising out of their contractual relation to its owners. Since this forms part of property rights, the argument could be advanced that the creditor is thus an owner as well. Indeed, privatisation through the purchase of company loans has been utilised by interested investors. However, considering the dimension of residual control, a creditor has no comparable standing to that of the proper owner. In any given political and social context, this right is regulated by the Constitution, respective laws (trade, commerce, etc.) and (where applicable) decrees by the country's rulers. In their totality they form the property regime in that particular setting and are an important focus of study and analysis.

The various forms of privatisation cover all four elements of the right to property, either together or separately. An example of the latter is a contract for management with a purchasing clause (a concept close to that of financial leasing), which implies an initial transferral of the right to use and manage and the right to revenue with a subsequent transferral of the right to control and (possibly) sell or exchange. It is conceivable that privatisation policies only envisage a partial transfer of property rights or impose certain limitations on the new owner, particularly when this is seen as more politically acceptable than full and unrestricted transferral by those taking the decision. Table 1.3 summarises some of the common limitations employed when privatising state-owned enterprises.

**Table 1.2: Definitions of Basic Islamic Concepts**

Notion	Islamic Concept
The relationships of human beings with God	<ul style="list-style-type: none"> <li>• Everything belongs to God, even human beings themselves.</li> <li>• Man is the vicegerent of God on this earth.</li> <li>• The key to Islamic philosophy lies in man's relationship with God.</li> <li>• Man holds property in trust for which he is accountable to God.</li> <li>• Different aspects of the Islamic social framework are united by one principle of Tawhid (the oneness of God).</li> <li>• With regards to the relationship of man and society to God, emphasis is laid on both purification and growth (tazkiyah).</li> </ul>
Pursuit of Wealth	<ul style="list-style-type: none"> <li>• In Islamic philosophy, there is no limit in the earning of wealth within the boundaries of Islamic principles.</li> </ul>
Class Structure	<ul style="list-style-type: none"> <li>• Emphasis on justly distribution of wealth and welfare.</li> </ul>
Social Justice	<ul style="list-style-type: none"> <li>• Emphasis on fair distribution of wealth.</li> <li>• Emphasis on human welfare and security.</li> </ul>
Spiritual Uplift	<ul style="list-style-type: none"> <li>• Predominant stress on moral values.</li> <li>• The fulfilment of spiritual and material need of individuals and society necessitate a vital role of the state.</li> <li>• The spiritual and material goals of a Muslim society can only be achieved if all the people in the society utilise their God-given talent with full efficiency and honesty.</li> </ul>
Concept of Development	<ul style="list-style-type: none"> <li>• Development includes moral, spiritual and material aspects.</li> </ul>
Ownership	<ul style="list-style-type: none"> <li>• Absolute ownership of man is a concept alien to Islam as it belongs to God. There are definite obligations towards others attendant upon the individual rights of ownership. The Iranian Constitution, claimed to be based on Shari'a, states that there are no prohibitions against wealth as long as long as it is legitimately acquired (Article 49).</li> </ul>

Source: Ahmad (1980), Siddiqi (1988), Naqvi (1989), Mannan (1989), Ahmad (1991), Ahsan (1991), Chapra (1992), Ahmed (1996), Rima (1996), Choudhury (1998).

**Table 1.3: Limitation of Property Rights During Privatisation**

Rights	Limitations		
Right to use and manage	a) obligations to preserve the area of activity	b) limitations on relations with third parties	c) limitations on the percentage of owned shares
Right to revenue	a) obligations for committing to an agreed investment programme	b) obligations for maintaining agreed levels of employment	c) obligation to pay off existing debts
Right to sell or exchange	a) limitation on the volume of assets that can be sold on to third parties	b) limitation on the volume of shares that can be sold on to third parties	

Source: Vickers and Yarrow (1989).

Most often, the above limitations are the result of a professed governmental policy regarding the future of the privatised enterprise. Usually it is the privatisation of enterprises of high significance for the economy of the country that is amenable to their exercise. There could be cases as well where limitations are imposed with more ulterior motives, in order to privilege a certain buyer or to frustrate the attempts to privatise a certain enterprise. In the analysis of the imposition of restrictions on the transfer of property rights, it is often hard to distinguish rhetoric from interest. While taking account of this difficulty, the following paragraphs outline the more obvious functions that each of the limitations above is meant to serve.

The obligation to preserve the area of activity is prompted by the lack of sufficient number of similar businesses or by the wish to prevent the diversion of assets created

with a particular purpose to other activities. The limitation regarding the relations with third parties is aimed at limiting the access of certain companies or individuals into the particular sector of the economy where privatisation occurs. The limitation on the percentage of owned shares by a single investor corresponds to the possible wish by the seller to avoid a high concentration of ownership within the domestic economy and hence prevent monopolies from forming.

The obligation to commit to an agreed investment programme is often prompted by the development strategies of the government aimed at boosting a certain sector of the economy or a certain enterprise that is technologically lagging behind its competitors or is important for the overall economy of the country. The requirement to preserve/enhance the employment level is usually imposed on investors for enterprises that are either major employers or operate in regions where employment is an important element of the governmental social policy. The obligation to pay off the debts of the privatised company is logically imposed for those enterprises that have accumulated large debt portfolios, particularly if those are towards state owned agencies, which the government is not prepared to transfer to the state budget.

As has been illustrated in this section, the history of ownership goes back a long way. Human beings have aspired to increase and expand the spectrum of their dominance on planet Earth by extending and enhancing their domain of proprietorship. As compared to the secular systems, Islam has varying philosophies and views about the extent and nature of the right of an individual to ownership. It is mentioned in the Qur'an that:

You who believe, do not use up one another's wealth to no good purpose, unless it is for some business based on mutual consent among you. Do not kill one another: God has been Merciful towards you (4:29).

On another occasion it is said:

You who believe, do not enter any houses except your own homes unless you are sure of their occupant's consent, and greet them politely (24:27).

Rafi' b. Khadij reported that the Messenger of Allah (may peace be upon Him) said:

One who cultivates on the land of other people without their permission, has no right on the yield except to the extent of his expenses (Siddiqi, 1988).

Whilst the Qur'an makes it explicitly clear that the ultimate owner is God and only God, the right of the individual to hold property is accepted and respected. The dichotomy of this God-Man relationship in terms of ownership is reconciled by the notion of trusteeship of man, and man's accountability to Him. Therefore, a state representing the will of God - an Islamic state such as Iran - may impose limits on individual property rights. According to the distinguished Iranian jurist Ayatollah Taleghani, the Islamic economy:

...bears distinguishing features, as it generally recognizes individuals as owners of the fruits of their labour and free agents in transactions, within the framework of the relevant ordinances (Taleghani, 1983:34).

Beyond these limits, it is the ruler (Islamic State) which functions as the owner or supervisor in regard to the public capital and exchange regulations within the public sphere. To this end, an Islamic-oriented economy:

...is not based on an unlimited freedoms to ownership, nor is it based on the public ownership that results in the total denial of individual ownership and freedoms... Property ties and



economic relationships are bound with human sentiments and instincts, and the social milieu reflects the totality of these ties. Islam envisions distribution, like production, as the natural and innate right of the one whose labour is involved, such that the individual is free to choose his labour, and labour is the source of the right of ownership (Taleghani, 1983:34).

**Table 1.4: Overview of Wealth and Ownership**

School of Thought	Description
<p>Pre-classical Plato &amp; Aristotle</p>	<ul style="list-style-type: none"> <li>• They believed that a minimum amount of wealth is essential to the good life. The household exists for the purpose of satisfying natural wants by producing useful commodities or acquiring them by exchange for consumption.</li> <li>• <b>Plato's view:</b> <ol style="list-style-type: none"> <li>1. A systematic expansion of the principles of society and the origin of the <i>city state</i> and the division of labour, and;</li> <li>2. The city arises because of the division of labour which itself is the result of natural inequalities in human skill and the multiplicity of human wants.</li> </ol> </li> <li>• <b>Aristotle's view:</b> <ol style="list-style-type: none"> <li>1. More private property with its liberal uses.</li> <li>2. In favour of money rather than barter or exchange.</li> <li>3. Against usury.</li> <li>4. His attack on the community of property is almost entirely based on the <i>incentive</i> argument; communal property will not be looked after as carefully as private property.</li> </ol> </li> </ul>
<p><i>Classical:</i></p> <p>Adam Smith (1723 - 1790)</p>	<ul style="list-style-type: none"> <li>• The last quarter of the eighteenth century and the beginning of the industrial revolution opened up vast possibilities of expansion to the recently established mode of industrial capitalism.</li> <li>• England was the most advanced capitalist country and its political structure had begun to change in accordance with the ideas of liberalism long before the French Revolution released its stimulus for the forces of liberalism everywhere.</li> </ul> <ul style="list-style-type: none"> <li>• The champion of the Laissez Faire approach.</li> <li>• He was under no illusion about the desire of individuals, including businessmen, to create a privileged position for themselves. But he nevertheless believed in the harmony of interest, because he thought that these privileged positions could only be maintained with state support without the intervention of government.</li> </ul>

<p>Ricardo (1772 - 1823)</p>	<ul style="list-style-type: none"> <li>• He believed in natural order; however, he did not doubt the compatibility of social harmony with the institution of private property. He also believed in the defence of the rich against the poor by the government and thought that property was the chief cause of authority and subordination.</li> <li>• Claimed that inherent natural order is superior to any order artificially created by mankind and the wise social organisation needs to act in harmony with the dictates of the natural order.</li> <li>• He stressed the point that the benefit of one should not conflict with the good of others.</li> <li>• He believed that labour is the main source of the wealth of the nation and it depends on the degree of productivity of the labour and the amount of useful labour.</li> </ul> <ul style="list-style-type: none"> <li>• <i>Theory of value and distribution</i>: the whole produce is divided among the three classes of the community, that the proportions of this division vary in different stages of society, that to determine the laws which regulate this distribution is the principal problem in political economy, and that hitherto there has been very little satisfactory information respecting the natural course of rent, profit and wages.</li> <li>• <i>Analysis of the causes of the value</i>: the discovery of the origin of the surplus product and consequent classification of different activities and classes of society and of various policies in relation to the production, accumulation and distribution of surplus.</li> </ul>
<p>Edmund Burke</p>	<ul style="list-style-type: none"> <li>• He was in favour of non-interventionism, except for state finance.</li> <li>• He favoured a wealthy and financially independent Church.</li> <li>• He was also in favour of rights of property.</li> <li>• In his philosophy, working classes are capable of governing.</li> </ul>
<p>Gentz (1764 - 1832)</p>	<ul style="list-style-type: none"> <li>• He thought that self-interest was the main motive of human conduct for the individual and society.</li> <li>• Regarded the development of trade, industry and scientific agriculture as unnatural, though he could not deny their usefulness.</li> <li>• Tried to compromise by stressing the power of public finance in moulding the economic activities of the community as a whole.</li> <li>• In favour of indirect taxation as an instrument of state policy.</li> <li>• Excessive power assigned to the state is much in evidence in his theory of money.</li> </ul>

<p><i>Marxism</i></p> <p>Karl Marx 1818 - 1883)</p>	<ul style="list-style-type: none"> <li>• Man is a social producer of his means of livelihood.</li> <li>• Labour, viewed as a producer of use-value, is not the source of value; for this labour cannot be exercised without some natural material.</li> <li>• The form in which the proportional division of labour operates in a society where the inter-connection of social labour is manifested in the private exchange of the individual products of labour, is precisely the exchange value of these products.</li> <li>• Social production involves certain social relations, the quality of which depends upon the degree of development of the social productive powers.</li> <li>• In order to allow the expanding productive process, the social change is essential. Therefore, political and legal institutions have to change and so will ideas.</li> <li>• Society can be classified on the basis of the factor of ownership of the material means of production. This division is the basis of the process of production and all other economic phenomena. Once economic relations have been established, the process of production itself makes them subject to change.</li> </ul>
<p><i>Modern</i></p> <p>Alfred Marshall (1842-1924)</p> <p>Keynes (1883 - 1946)</p>	<ul style="list-style-type: none"> <li>• In Marshall's view, the forces behind supply and demand are:             <ol style="list-style-type: none"> <li>1. Behind demand is marginal utility - reflected in demand prices of buyers.</li> <li>2. Behind supply is marginal effort and sacrifice - reflected in the supply price.</li> </ol> </li> <li>• The equilibrium between supply and demand can be considered as:             <ol style="list-style-type: none"> <li>1. the market value equity of supply and demand, when the supply is assumed to be fixed.</li> <li>2. the nominal values, which relate to short or long periods.</li> </ol> </li> <li>• Keynes was concerned with aggregate income consumption, savings and investment, rather than with the determination of individual prices which formed the core of the economic theory.</li> <li>• Regarding the supply and demand functions:             <ol style="list-style-type: none"> <li>1. Effective demand is defined as the aggregate income which the entrepreneurs expect to receive, inclusive of the income which they will hand on to other factors of production, from the amount of current employment which they decide to give.</li> </ol> </li> </ul>

	<p>2. A supply function can be established, relating the aggregate supply price of the output obtained by employing a variable number of men with that number.</p> <ul style="list-style-type: none"> <li>• The level of income determines the volume of employment. Furthermore, it is determined jointly by the level of consumption and by the level of investment.</li> <li>• Functional relation of the employment, consumption and investment gives a certain marginal propensity to consume.</li> <li>• The psychological attitude to liquidity and the psychological expectation of future yield from capital assets.</li> <li>• <i>Determinants of the volume of investment</i>: when someone invests they purchase the rights to the series of perspective net returns, which they expect to obtain from selling, the output of the capital asset in which they have invested during the life of the asset (marginal efficiency of capital).</li> <li>• Emphasis of government intervention when aggregate demand is inadequate to create full employment.</li> <li>• The essentials of the capitalist system could be preserved without sacrificing full employment if government exercises proper control.</li> <li>• There are certain areas that should not be left to individual initiative.</li> <li>• State has to exercise a guiding influence on the propensity to consume partly through the taxation schemes and partly by fixing the rate of interest.</li> <li>• He proposed a mixed economy in which investment is socialised but in which private self-interest will continue to function in all areas in which it is compatible with full employment. He regarded this as “the only practicable means of avoiding the destruction of existing economic forms in their entirety and as the condition of the successful functioning of individual initiative”.</li> </ul>
<p>Chicago School of Thought: Frank Knight (1885 - 1946)</p>	<ul style="list-style-type: none"> <li>• Frank Knight is considered the leader of this school, who emphasised the theory of individual choice based on the households as the production units that seek to maximise utility much as firms seek to maximise profit.</li> </ul>
<p>George Stigler (1910 - 1991)</p>	<ul style="list-style-type: none"> <li>• They were pioneers in promoting law and economics as the chief interdisciplinary field of the social sciences by studying the effects of the assignment of property rights.</li> </ul>
<p>Milton Friedman (1912 - 2006)</p>	<ul style="list-style-type: none"> <li>• This school was interested towards the analysis of growth in underdeveloped countries via market mechanisms.</li> <li>• They were pro-liberalisation and economic freedom as a means to achieve higher efficiency of the market.</li> </ul>
<p>James Buchanan (1918 - )</p>	<ul style="list-style-type: none"> <li>• They emphasised the usefulness of sovereignty of consumers for maximising behaviour in their economic activity.</li> <li>• They stressed the point that in addition to the stock of physical capital and increasing the labour force, the technical progress and human capital are also important.</li> </ul>

	<ul style="list-style-type: none"> <li>• They believed in the philosophy of profit maximisation as a response to the incentives given to them (labour force) in underdeveloped countries.</li> <li>• The market mechanism can stimulate efficiency and growth in an underdeveloped economy more effectively than the alternative policy of governmental planning as an instrument of economic development.</li> <li>• The necessity for encouraging the emergence of 'entrepreneurial personalities' in underdeveloped countries is a matter of special concern.</li> <li>• They urged government to facilitate private investment by supplying data not generally available to individuals. Education, free elections and nationwide media were regarded as being useful in opening up an otherwise closed society.</li> </ul>
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Source: Keynes (1936), Knight (1950), Polanyi *et al.* (1957), Walsh and Gram (1980), Lowry (1987), Betz (1988), Rima (1988; 1996).

I have summarised the history of Western economic thinking here for two main reasons. Firstly, it can be seen that there is not, any more than there is in Islam, one simple consensus view. Instead, there is a series of complex and continuing debate. Although it is sometimes fashionable to agree that there is a telos, a tendency for a single meaning to emerge in these debates, this is not really the case. Nor is it the case in Islamic economic argument. Secondly, as this thesis will explore with respect to privatisation, these debates have interacted. It is perhaps going too far to say that there is a 'conversation' between Western and Islamic debates on privatisation, but there have at least been elements of a dialogue. This thesis tries to promote that conversation. The discussion of Western economic thinking, necessarily brief, is a basic building block in understanding the shape or boundaries of that conversation.

#### 1.5.4 *Alternatives to Privatisation*

Privatisation is not the only way in which a state can divest itself of economic industries. Another method is corporatisation. This serves as an alternative to either full nationalisation or full privatisation, with features in common to both. It is in many ways the road that Iran has taken in the past, an issue which will be discussed in later sections. However, it is important to deal with the possibility here for the sake of thoroughness in our analysis.

Corporatisation is, at its most basic level, the process of moving the control of industries from direct control by the government to control by government-owned corporations (Personal Communication).<sup>3</sup> Within this definition there is room to manoeuvre. The government's control may be by specific bureaucracy with sovereign power or a bureaucracy itself controlled by other officials. The corporation may be manned by government officials or have private citizens in charge. The government may retain some control over the corporation or divest it all. In some cases, corporatisation may simply be another way for the government to maintain control. However, in general corporatisation is usually a method of economic reform and it will generally occur either as an alternative to full privatisation, as a middle ground, or as a stepping stone to full privatisation.

The process of corporatisation involves converting the government bureaucratic departments which are in charge of the industry into public companies. Commercial boards of directors are then inserted in between the ministers of the government in charge of the industry and the managers of the corporation (Personal Communication).<sup>4</sup> In this way, there is a mixture of the government still having strategic control of the

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<sup>3</sup> Personal Communication - various discussions with Abdullah P. Hosseini, Head of Iran's Privatisation Organisation (IPO), during August 2004.

<sup>4</sup> Personal Communication - discussions with Seyed Ahmad Mir Motahari, Head of Iran's Privatisation Organisation (IPO), December 2003.

organisation, but the efficiencies of private industry can be taken advantage of and some of the inefficiencies of government oversight can be controlled for. However, this process of corporatisation does not generally create the level of efficiency necessary to compete with truly private corporations, without government subsidisation.

## **1.6 Privatisation From a Comparative Perspective**

This section considers privatisation relative to the geographical area in which they occurred in the neighbouring countries of Pakistan, Azerbaijan, Kyrgyzstan and India, and then in the sectorally related countries of Egypt and China. India, Pakistan, Egypt and China, with a large population and very old public sector enterprises, have all followed import-substituting industrialisation, in which state enterprise has played a leading role, whilst Azerbaijan and Kyrgyzstan were liberated from a command economy with a totalitarian regime, after the break-up of the Soviet Union. In 1982, Kirkpatrick (1982) claimed that the difference between totalitarian and authoritarian states is precisely that authoritarian regimes may become more democratic and pluralistic because they leave civil society intact. Totalitarian regimes, in contrast, cannot be expected to relax control and evolve into freer societies. Egypt is grouped in this study as one of the authoritarian regimes in the region.

Privatisation of the Russian comparator experience, in the northern borders to the Islamic Republic of Iran, whilst appearing to be an obvious case for a comparative study in this undertaking, was left out of this thesis simply because of the nature of its attempts and methodology in 'corporatisation'. The Russian model adopted a national voucher system, carrying out the first phase of the programme with 750 bid reception centres in more than 85 regions, in anticipation of giving 144 million participating Russians a chance to become, along with insiders, owners of enterprises (World Bank, 1995). Commencing in November 1991, by June 1994 some 12,000 - 14,000 medium-sized and large enterprises had been transferred to private ownership. The national

voucher auction system was disbanded in 1994, due to the many objections leading to what was to become known as the 'piratisation of Russia' (Goldman, 2003).

### **1.6.1 Geographically Related Cases**

Iran's privatisation programme does not occur as an isolated incident in the region. There are numerous examples among its neighbours (closer or more distant) of policies, strategies, institutional settings, legal frameworks and implementation mechanisms. Relevant to consider in order to contextualise to a certain extent the Iranian experience are the cases of Pakistan, Azerbaijan, Kyrgyzstan and India. One has to acknowledge of course the limitations of the comparative approach and account for the likely possibility that the privatisation policy of the Islamic Republic could be exclusively home-grown. The spiritual leader's pronouncement of 3 June 2006 on the general policies Article 44 of the Constitutional Laws of June 2004, pertaining to the specifics of divestitures of state owned entities illuminates the specificity of the Iranian privatisation policy. Currently, Pakistan and India are negotiating with Iran on the transfer of gas through a pipeline which has now been termed the 'peace pipeline', while Azerbaijan and Kyrgyzstan are interested in oil swap contracts through the Caspian Sea, for delivery to the Persian Gulf. Hence the selection of these countries for a case study in the following section.

#### *1.6.1.1 Pakistan*

In Pakistan, the impetus for privatisation has derived largely from the negative experience of state-owned enterprises (SOEs) (Pakistani Privatisation Commission,



2004).<sup>5</sup> Since the early 1970s, as in most developing countries, Pakistan has relied on the public sector to operate virtually all infrastructure and financial services and many industrial units. The government nationalised many businesses and enlarged the areas where the private sector was prevented from competing. In addition to a number of important industrial enterprises, the government owned and operated services in banking, energy, communications, infrastructure and transport. The following problems persisted and created an incentive to privatise state-owned companies: a) mismanagement and overstaffing; b) inappropriate and costly investments; c) poor quality and coverage of services; d) high debt and fiscal losses; e) production and profits well below potential.

The actual privatisation policy of Pakistan commenced with the creation of the Privatisation Commission on 22 January 1991. Although the Privatisation Committee mandate was initially restricted to industrial transactions, by 1993 it had expanded to include power, oil and gas, transport (aviation, railways, ports and shipping), telecommunications, banking and insurance. Between January 1991 and June 2003, the Commission completed 132 transactions totalling Pakistani Rs101.027 billion (£940.455 billion at current exchange rates). The first figure (i.e. the number of transactions) strikes as very low (slightly more than ten transactions per year on average), while the second is very high (i.e. revenues of around £78.300 billion pounds per year). Obviously the companies sold have been of high calibre. The distribution among sectors is as follows: a) 43% from sales in the banking and capital markets; b) 24% from sales in the energy sector; c) 18% from sales in the telecom industry and d) 15% from other sectors of the economy.

In terms of organisation, the Privatisation Commission has the right of initiative for the sale of any given enterprise. It approaches the owner ministry with the so-called

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<sup>5</sup> This section is based on official information published by the Pakistani Privatisation Commission (2004). Information on privatisation available on-line at [www.privatisation.gov.pk](http://www.privatisation.gov.pk)

summary of why divestiture is desirable and could also seek guidance on issues relating to such matters as pricing, restructuring, legal considerations and regulatory framework. Following this, the proposal is submitted to the Cabinet or its subcommittee on privatisation for approval. If the latter is granted, the Privatisation Commission has the option of hiring external advisors to evaluate the value of the company and prepare for its restructuring and divestiture. During the whole process it remains in control and approves each of the steps. The most often used privatisation method is bidding, whereby the highest bidder is selected and the contract is submitted for approval by the Commission's board. Practice shows, however, that the privatisation process is lengthy, mainly in order to ensure its transparency. On average, it has taken about eighteen months to close a major transaction, even when no major restructuring of the company is required, which explains the above statistics.

#### *1.6.1.2 Azerbaijan*

Privatisation in Azerbaijan has taken a somewhat different path (IMF, 1995). The policy was initiated in the mid-1990s with the following objectives: a) the establishment of a self-regulated market economy space for economic entities based on private ownership and free competition; b) the restructuring of the national economy in accordance with market-economy requirements; c) the involvement of all unused resources into an economic process (unfinished and decommissioned industrial objects, real estate, population's free resources, entrepreneurial potential etc.); d) the mobilisation of investments, in particular foreign funds, to the national economy; and e) the improvement of social conditions and the population's living standards. Right from the start, the Azeri policy-makers indicated their wish to open the economy to foreign capital, perhaps correctly assessing the inadequacy of domestic resources, and to allow property acquisition by overseas legal and physical persons.

The central privatisation organ is the Azeri State Property Committee, which has no right of initiative for divestiture. It is the seller, not the owner of state enterprises. Initiative belongs to the respective ministries, which are required to submit to the State Property Committee recommendations relating to privatisation. Only then is the Committee enabled to work out the particular details in preparation for the deal with due account to the opinion of the State Committee of Antimonopoly Policy. From the date on which the privatisation deal is concluded, all powers delegated by the state to any ministry, body, association, local executive authority, etc. cease to exist and the State Property Committee is charged with overseeing the implementation of all post-privatisation commitments by the new owner, if such have been introduced in the contract..

#### *1.6.1.3 Kyrgyzstan*

Similar is the case in Kyrgyzstan, which launched its privatisation programme in 1991 (World Bank, 1998). Since then there have been three distinct phases to the process. Phase I lasted from 1991 to 1993. It focused on the establishment of the legal framework and institutional infrastructure required to enable ownership of private property (other than land) and private enterprise. This period saw two principal approaches to the privatisation of companies: a) small-scale privatisation of more than 3,400 enterprises in retail trade, catering and services that have been sold via cash auctions and b) a mass privatisation programme, whose purpose was to transfer a portion of state property to the citizens of Kyrgyzstan free of charge in order to compensate them for their life-time contribution to the economy. Phase II lasted from 1993 to 1996 and began with the adoption of a new privatisation strategy, bringing about one important change. This was the creation in May 1994 of the Enterprise Restructuring and Resolution Agency under the World Bank-supported Privatisation and Enterprise Sector Adjustment Credit. The agency started to deal with large state-

owned loss-making enterprises, which needed either radical restructuring to enable their sale or, failing this, liquidation.

Phase III was inaugurated in February 1996 through a governmental decree. It allowed the usage of previous privatisation mechanisms, such as coupon auctions, cash auctions and competitive tendering for large investment projects. It is, however, distinguished from the previous periods by the nature of the companies involved - predominantly large-scale enterprises in mining, construction, transport and tourism, public utilities and infrastructure projects. It also included a number of companies that had already been partially privatised but in which the government continued to retain significant shareholdings. It was decided that those holdings would be reviewed individually and, where possible, offered for sale by the State Property Fund. In Kyrgyzstan, the State Property Fund was not the only the seller of state-owned companies but also their owner through a transfer of shares from the respective ministries, which presumably generated a higher level of independence for its operation.

#### *1.6.1.4 India*

Finally, the privatisation process in India has been driven by the need to meet the increasing domestic demand in the economy and of mobilising additional capital to set up the necessary infrastructure to support it (Mishra and Navin, 2002).<sup>6</sup> The privatisation environment is assessed as lacking in attributes that are fundamental to market economy, such as open access, fair play and competition, as well as attributes that are essential for protecting the interests of the consumers. The attempts to create an environment suitable for private investment have triggered the process of reform, restructuring and deregulation. In the wake of economic liberalisation in 1991, the

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<sup>6</sup> See also [www.indiacore.com](http://www.indiacore.com).

response from the private sector in India had initially been overwhelming. However, the government's policy towards the participation of non-state entrepreneurship participation in its infrastructure development had been assessed as fundamentally flawed. For example, in the power sector the government opened up the energy production for private investment, while it has been argued that privatisation should have started with the energy distribution network.

In these conditions, amendments to the policies have become a routine exercise rather than an exception, introducing a high level of uncertainty for potential buyers (Mishra and Navin, 2002).<sup>7</sup> Typical for India is also the institutional breakdown of the privatisation task. Rather than having a central authority, either independent or subordinated to the government, a number of agencies have been created dealing with the different sectors of the economy. Over the past years have emerged the Central Electricity Regulatory Commission, the Telecom Regulatory Authority, the Insurance Regulatory Authority, the National Highway Authority, the Inland Waterways Authority, the Airport Authority, etc. Besides their normal functions of advising respective ministries on policy-making, they have also been discharging many regulatory functions and functions with respect to the transferral of certain state economic responsibilities and assets to the private sector.

### **1.6.2 Sectorally Related Cases**

Privatisation in the oil and gas industry is a topical issue, and not only for the countries where it represents a sizable chunk of the national economy. Where revenues from the exploitation of oil and gas reserves represent a significant contribution to the budget, the pressure on governments to modernise extraction facilities and streamline production

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<sup>7</sup> See also [www.indiacore.com](http://www.indiacore.com).

are increasingly higher. Also, where capacity to keep up with technological developments around the world is lacking, the case is strong for enlisting the participation and support of foreign investors (Personal Communication).<sup>8</sup> This has most generally happened under the mechanism of concessions or guaranteed exploitation periods/quotas, but has also been subject to a discourse (whether intended or rhetorical) of privatisation. A number of cases are relevant in this respect and are considered below.

#### *1.6.2.1 Egypt*

Egypt's petroleum industry plays a key role in the economy. The country is an oil exporter, so the industry is one of the main sources of foreign exchange. The upstream oil and gas industry generates 10% of the GDP, with oil accounting for about 40% of total export revenues. Egypt's 1999 proven oil reserves estimates are given at about 3.5 billion barrels (Mbendy, 2005). The main areas of exploration for oil and gas are the Gulf of Suez, the Nile Delta, the Western Desert, the Sinai Peninsula and the Eastern Desert. The Gulf of Suez, although mature with decreasing production levels, remains the major source of oil. The decrease in production levels together with the increase in domestic oil consumption (associated with gradual industrial growth in Egypt) has generated fears that by 2010 Egypt could become a net importer of oil.

This has generated policies of attracting foreign investors with know-how and technology to participate in the upgrading of the country's oil and gas industry. The government, through the state-controlled Egyptian General Petroleum Corporation (EGPC), has offered attractive exploration terms to overseas companies and this has helped to dramatically increase oil and gas exploration and discoveries in the past

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<sup>8</sup> Personal Communication. Discussion with Mohammad Alipour-Jeddi, Head of Petroleum Market Analysis Department, OPEC, NIOC Headquarters, Tehran, December 2005.

decade. For example, the production volumes of 1999 had doubled by 2003. Following the introduction of an IMF stabilisation programme in 1991, the Egyptian government began a reform of its fiscal policy and announced attractive incentives for foreign investment and exploration, and a commitment to a policy of privatisation. The improved incentives for exploration have included the provision of larger exploration blocks, increased cost recovery allowances and increased agreement periods (Personal Communication).<sup>9</sup>

There has been significant progress in privatisation, trade liberalisation and deregulation during the 1990s. However, it has concerned mostly pervasive state-ownership in areas such as telecommunications and utilities (e.g. the Egyptian Electricity Authority). The General Petroleum Corporation and Egypt Gas (the natural gas administration) have not been considered, apart from contracts of limited exploration, similar to the buy-back agreements employed in Iran. Traditionally in Egypt this has taken the form of joint ventures with multinational companies, without a transfer of property rights. After 1973, the joint venture scheme was replaced by production sharing agreements, again with no transfer of property rights from the state to private companies. Whereas privatisation in the other sectors of the economy has been slowed down due to the large debts of state-owned enterprises, privatisation in the oil industry is not on the table due to its strategic importance (World Bank, 1997; Ibrahim and Ibrahim, 2003).

### *1.6.2.2 China*

In China, the importance of the oil sector is not as much in terms of export revenues as in terms of meeting domestic demand. In late 2003, China surpassed Japan to become the world's second largest petroleum consumer after the USA. Associated with rapid

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<sup>9</sup> Personal Communication - discussions with Seyed Ahmad Mir Motahari, Head of Iran's Privatisation Organisation (IPO), February 2004.

economic growth, as argued by Logan (2005), internal Chinese demand grew 15% to 6.37 million barrels per day during 2004, about one-third the level in the US. In comparison, domestic oil output in China has grown only very slowly over the past five years. As a result imports of crude oil grew rapidly in 2003 and 2004, increasing by nearly 75% over the course of the two years. This has generated a push towards modernising the oil and gas sectors by governmental investment, but also through the involvement of overseas companies.

With China's accession to the World Trade Organisation, the government made several important commitments regarding the energy and oil industry. It agreed to gradually open the crude and refined oil sectors to private traders and to cut its state monopoly on oil trading by giving up 4 million tons of oil products and 10% of crude imports to the private sector. After three years of accession, China would also deregulate retail oil distribution by enabling foreign investors to have at least thirty privately-owned petrol stations each. It pledged to open its wholesale market five years after accession. By December 2004, China has removed import quota management for the three state-owned oil companies China National Petroleum (CNPC), China Petroleum Company (Sinopec) and China National Offshore Oil (Anon, 2004a). In October, French oil giant Total was allowed into a joint venture with Sinopec to develop petrol stations in China, and in November, British Petroleum signed with Sinopec and CNPC to build petrol stations.

In terms of privatisation (Majumder, 2003), a broad sectoral policy was announced at the 15th Central Committee meeting of the Chinese Communist Party in 1999. Its leadership reaffirmed the earlier stance of Jiang Zemin and approved the programme, thus eliminating the political constraints over the issue. The concrete policy on privatisation was announced in the 3<sup>rd</sup> Five Year Plan in 2001. According to it, the economy was divided into three: a) areas of highest national priority, which could not be relinquished from full governmental control; b) areas which need joint participation



and would remain partially controlled; c) areas in which complete privatisation would be allowed. Defence, for example, fell in the first group, while public services and national priority sectors, such as power, waterworks, gas, onshore oil and transport fell in the second group of state-controlled development with private participation.

At the initial stage, China faced internal squabbling over privatisation. After the Congress meeting in 1999, there were disputes between the reformists and conservatives. With the former winning the upper hand, local governments started to sell small and medium sized state-owned enterprises. The adopted privatisation strategy for the large companies was two pronged. In the first phase, they would be converted into joint stock companies/cooperatives and, in the second, the government-held shares would be partially divested to private enterprises, including managers and employees (Personal Communication).<sup>10</sup> Most probably as a result of its privatisation programme, in 2002 China was the world's biggest beneficiary of foreign direct investment. In the oil sector, however, governmental control has remained the norm rather than the exception, owing to its overwhelming importance for the future economic growth in the country.

Rather than looking to sell assets of the domestic oil industry, the Chinese government has instead sought to diversify its supply portfolio by acquiring them overseas. Over the past decade, Chinese oil imports have come from an increasingly wider net of suppliers. In 1993, for example, almost all of them came from Indonesia, Oman and Yemen. By 2004, Saudi Arabia was China's largest supplier accounting for 14% of imports, with Oman, Angola, Iran, Russia, Vietnam and Yemen together supplying another 60% (Personal Communication).<sup>11</sup> The current (3<sup>rd</sup>) Five-Year Plan (2001-2005) calls for the construction and use of strategic petroleum reserves by the year 2005. Construction has

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<sup>10</sup> Personal Communication - discussions with Seyed Ahmad Mir Motahari, former Head of Iran's Privatisation Organisation (IPO), February 2004.

<sup>11</sup> Ibid.

begun at one of four sites destined to store government-owned supplies and Chinese officials plan to gradually fill up to 100 million barrels of storage by 2008 (equivalent to roughly 35 days of import).

Within this strategy, Chinese state-owned oil companies have accelerated their hunt for overseas oil assets. Until recently, they had been most comfortable operating in locations not dominated by the world major oil giants. Sudan, Angola and Iran are pertinent examples. Currently, over half of the Chinese overseas oil production comes from Sudan. Most recently, outward activity has also gathered speed in other areas, including Russia, Kazakhstan, Ecuador, Australia, Indonesia and Saudi Arabia. The impressions shared by Logan (2005) is that Chinese companies seem to be improving their ability to purchase assets without overpaying, as earlier reports have suggested and to develop more effective business skills.

Leading the drive among Chinese state-owned companies, the CNPC claims to have petroleum assets in 30 countries. It plans to spend \$18 billion in overseas oil and gas development between now and 2020 (Anon, 2005a). Most of CNPC's overseas production currently comes from Sudan, Kazakhstan and Indonesia. Many speculated that CNPC would take a share in the restructured assets of Yukos, while rumours in late January 2005 foresaw a \$6 billion 'loan' by CNPC to Rosneft for long-term oil purchases, but no equity investment. By comparison, Sinopec is newer to the international investment in the oil sector than CNPC. It has recently started pumping smaller quantities of equity oil from operations in Yemen and Azerbaijan. The largest of Sinopec's overseas contracts was signed with the Iranian government in 2004 and envisaged an investment of \$70 billion over 25 years to purchase cargoes and to participate in upstream oil activities.

## **1.7 Conclusion**

This chapter has examined the theoretical background to privatisation, providing the theoretical framework within which any privatisation takes place, regardless of the state, culture or economic situation in question. It is the context that Iranian privatisation of the oil and gas industry must take into account regardless of other factors that have been or will be discussed in this thesis.

Similarly, the precedents set by other historical examples of privatisation in the region and outside the region also form the context in which Iranian privatisation of the oil and gas industry will take place. Although the constraints of comparative precedents are less severe than those imposed by theoretical possibility, they nevertheless constitute limitations which must be taken into account. They have the effect of creating and providing a) precedents, which formed the impetus for privatisation in different countries and therefore affect decision-making in Iran; b) specific models for an Iranian privatisation of the oil and gas industry; and c) lessons learned from these precedents, which will help deciding what not to do in any Iranian privatisation.

Thus, the chapter has provided the realms of possibility which determine and constrain policy-makers in making and implementing decisions. These conclusions will therefore address the particular constraining factors as a means of providing the 'take away' context for the rest of the thesis. It will illustrate the necessary boundaries of any future Iranian privatisation, as well as the probable constraints.

### **1.7.1 *Theoretical Boundaries***

At the most fundamental level, privatisation in Iran will be determined by how we define privatisation. The specific sense in which we tend to use the term here is that privatisation entails the transfer of property and control rights over given enterprises,

infrastructure and other economic establishments from the state to the private sector. However, there is a wider sense in which the term can be approached, which refers to enhancing the effectiveness of the non-state economic sector. These two understandings of privatisation do not necessarily fully overlap.

Therefore, this thesis argues for a broader, more inclusive understanding. That is a process, which incorporates broad measures of economic liberalisation, such as reducing state paternalism, the removal of bureaucratic obstacles for economic agents and the improvement of the functioning of state-owned enterprises. This broader understanding of privatisation ensures the incorporation of meanings that the Iranian government will tend to use, and also allows for comparisons with other state's perspectives on privatisation.

We have also excluded some related concepts. These include commercialisation, which implies the extraction of state-owned enterprises from the framework of state-planning; decentralisation, which is defined as the process of transferring ownership and control rights from central to local structures of state authority, whereby state planning acquires a dimension of a mere summary of local economic planning; deregulation, which implies the withdrawal of the state from many aspects of the country's economic life through, *inter alia*, the liberalisation of prices, etc.; and the concept of divestiture, which presupposes the spin-off of filials, branches or units of a given enterprise.

In accordance with this theoretical understanding of privatisation, the chapter has also drawn the boundaries of the different possible types of privatisation. These include:

- the scope of privatisation, from the complete withdrawal of the state versus the preservation of a certain level of state ownership;
- the means of privatisation, from public offering of shares, which can be aimed at attracting foreign buyers or at stimulating the acquisition of economic assets by

domestic companies, or a combination of these two types of investors in a single joint venture company;

- privatisation which can be implemented by a specialised state organ, a governmental ministry, an intermediary or by the enterprise board;
- ownership which can be by the central government and/or municipal authorities;
- different levels of privatisation;
- privatisation which can take place in different economic sectors; and
- there is a distinction between a monopoly and non-monopoly market share of the privatised enterprise.

Any analysis of Iranian privatisation will have to take into account these factors in determining the type, scope and means of privatisation.

The most fundamental, underlying issue of privatisation is the nature of the right to property in the state in question. This chapter has pointed to the fundamental dilemma that potentially underpins privatisation, that is, that there is an inherent conflict between the possibility for a state to transfer economic ownership to private companies, and the possibility for it to guarantee the continuity of the economic and social policies it has been implementing, or would like to implement, in the specific sector subject to privatisation. Iran, like any other state, must overcome this dilemma. Therefore, in any potential move to privatisation, there are certain limitations that ought to be considered.

These include:

- obligations to preserving the area of activity;
- limitations of the relations with third parties;
- limitations on the percentage of owned shares;
- obligations for committing to an agreed investment programme;
- obligations for maintaining agreed levels of employment;
- obligations to pay off existing debt;

- limitations to the volume of assets that can be sold to third parties; and
- limitations to the volume of shares that can be sold on to third parties.

Finally, though not necessarily a theoretical boundary, the notion of privatisation is to some degree circumscribed by the possibility of using other methods that bring about similar results. This chapter pointed to the notion of corporatisation which is, at its most basic level, the process of moving the control of industries from direct control by the government to control by government-owned corporations. It was also pointed out that within this definition there is room to manoeuvre. Therefore, an analysis of privatisation in Iran must make sure not to confuse the two possibilities, as well as the effects that the choice of one possibility over the other will have on the future economic situation.

To summarise, there are four theoretical factors that need to be taken into consideration in our analysis of Iranian privatisation of the oil and gas sector. These are:

- the definition and understanding of what privatisation actually entails;
- the boundaries set by other forms of economic change and alternatives to privatisation;
- the different possible types and levels of privatisation; and
- the limits and obligations within any privatisation deal, as set by the basic concept of the right to property.

### **1.7.2 Constraints**

This chapter has looked at the precedents of privatisation in terms of two different sets of comparative case studies. The first set included those cases which are relevant to Iran in that they are geographically close to the country. Thus, the neighbouring states of Pakistan, Azerbaijan, Kyrgyzstan and India were considered. Although these states are

not necessarily similar to Iran in political, economic and, specifically, privatisation terms they are nonetheless pertinent and need to be looked at. While assuming their differences, there is also good reason to believe that the common historical and geographical features of the region have produced certain common denominators in this group of countries. The second set of case studies looked at states which, while not geographically close to Iran, are nevertheless relevant to the Iranian case, because they share similarities with regard to the sector of potential privatisation, the oil and gas sector. These states include Egypt and China. This is not to say that the oil and gas industry is the same in these countries, or even the main focus of interest for the purposes of this study. It is rather the importance of the sector for their national economies which makes these cases interesting. It is suggested that Egypt and China are cases where the revenues from the exploitation of oil and gas reserves represent a significant contribution to the budget, which explains the increasing pressure on their governments to modernise extraction facilities and streamline production. However, if the capacity to keep up with technological developments around the world is lacking, there is a strong case for enlisting the participation and support of foreign investors. This has often led to the use of the mechanism of concessions or guaranteed exploitation periods/quotas.

Within both of these sets of case studies, it is possible to point out three important factors for this analysis. The first one is the need of an impetus for privatisation. The second is that there are a number of different models for the actual implementation of privatisation that recur across different countries. The third is that there are certain lessons to be learned from the existing precedents of privatisation.

### *1.7.2.1 Impetus*

One of the relevant findings in the comparative section, noted in regard to the case of Pakistan, is that in some so-called developing states one of the primary factors leading to privatisation has been the impetus for privatisation, largely derived from the negative experience of state-owned enterprises (SOEs). Such negative experiences include the following elements:

- mismanagement and overstaffing;
- inappropriate and costly investments;
- poor quality and coverage of services;
- high debt and fiscal losses; and
- production and profits well below potential.

These elements have affected, and continue to affect, Iran as well and serve as an impetus for its move towards privatisation.

Another similar set of elements have to do with the nature of the market in question. As noted in the case study on India, there are issues of inefficient markets which can lead to a need to privatise. These include:

- lack of open access;
- limits on 'fair play' and competition; and
- attributes that are essential for protecting the interests of the consumers.

In India, as in other developing economies, the attempts to create an environment more suitable for competition in the world market needed to address these issues. One of the means to do this has been the privatisation of a number of industries.



Related to this is the fear that the relative competitiveness of states may sink to such an extent as to completely turn around. For instance, it was noted in the case of Egypt that the decrease in production levels together with the increase in domestic oil consumption has generated fears that Egypt could become a net importer of oil. Such hard, cold fears of dependence strongly drive the need to become more competitive.

This is opposed to China, where the importance of the oil sector is not so much in terms of export revenues as in terms of meeting domestic demand. It was noted, for instance, that in late 2003 China surpassed Japan in becoming the world's second largest petroleum consumer after the USA. Yet, in comparison, domestic oil output in China has grown only very slowly over the past five years. As a result, imports of crude oil grew rapidly in 2003 and 2004. In turn, this generated a push towards modernising the oil and gas sectors not only by governmental investment, but also through the involvement of overseas companies. While Iran is not necessarily at this stage with regard to its oil sector, the argument is valid in that Iran is a net importer of gas (Anon, 2005a).

#### *1.7.2.2 Models*

This chapter has illustrated a number of different models of privatisation. It is perhaps worth reviewing them in that they delineate the scenario for the possibility of a new Iranian model. As noted in the introduction to this chapter, agents affect structure as much as structure affects agents – through the process of structuration – and therefore while the Iranian model may differ it will ‘feed off’ other models. Subsequently, in the future, the Iranian model will also form the structure upon which other models emerge.

The Pakistani model of privatisation involved, at its heart, a privatisation commission which has the right of initiative for the sale of any given enterprise. It must go through

the owner ministry and also seek guidance on issues relating to such matters as pricing, restructuring, legal considerations and the regulatory framework. The proposal is submitted to the Cabinet or its subcommittee on privatisation for approval. During the whole process it remains in control and approves each of its steps. The most often used privatisation method is bidding.

The model used in Azerbaijan differs from that applied in Pakistan. In Azerbaijan, the central privatisation organ is the Azeri State Property Committee, which has no right of initiative for divestiture. It is the seller, not the owner of state enterprises. As opposed to the Pakistani model, the initiative for privatisation belongs to the respective ministries. These ministries are then required to submit to the Azeri State Property Committee recommendations relating to privatisation. Only then is the committee enabled to work out the particular details in preparation for the deal. Kyrgyzstan has used a similar model.

The Egyptian model differs yet again. Without getting into the full model, it is notable that a particular practice in the Egyptian system has been to attract foreign investors with know-how and technology to participate in the upgrading of the country's oil and gas industry by offering them attractive exploration terms, through the state-controlled EGPC. The improved incentives for exploration have included the provision of larger exploration blocks, increased cost recovery allowances and increased agreement periods. This has helped to dramatically increase oil and gas exploration and discoveries over the past decade.

Finally, the Chinese model also differs, though mainly because of the different situation experienced in China, which is demand driven. While the entire process of Chinese privatisation is not reviewed here, one interesting aspect is that the economy is divided into three: a) areas of highest national priority, which could not be relinquished from full governmental control; b) areas which need joint participation and would remain

partially controlled; and c) areas in which complete privatisation is allowed. Similarly, in other states, it is likely that privatisation will take different forms in different industries.

### **1.7.3 Constraints – Lessons Learned**

Lastly, there are some lessons to be learned from the different models and historical precedents of privatisation.

One notable lesson learned is that the timing of privatisation will depend on the model used. For instance, based on the Pakistani model, it was noted that the privatisation process is lengthy. This has been undertaken mainly to ensure its transparency. However, on average it has taken about eighteen months to close major transactions. This is a long period of time considering that it applies even when no major restructuring of the company is required. The lesson learned for Iran is that even though privatisation may be agreed upon, the nature of the method of privatisation will have a huge effect on the timeframe within which privatisation is actually carried out. The time factor must therefore also be considered in any analysis and predictions of future investment.

Another lesson learned is that the government in question may simply be incorrect in its assessment of the privatisation context and the changes proposed and/or made in the economic system. For instance, in the Indian case study, it was noted that the government's policy towards non-state entrepreneurship participation in its infrastructure development has been assessed as fundamentally flawed. One example that was noted, although not the only one, was that of the power sector where the government opened up the energy production for private investment, while it was argued that privatisation should have started with the energy distribution network. An

result of this flaw was that amendments to the policies have become a routine exercise rather than an exception, introducing a high level of uncertainty for potential buyers. This is relevant for Iran in that it is often assumed that, in theory, the government will carry out a fairly correct analysis of the situation and that its policy will conform to this. However, we must keep open the possibility that such an assumption may be wrong and that the government may simply make a mistake.

Another lesson is that different industries may or may not privatise depending on their type. In particular, those industries which are considered to be 'strategic' are generally less open to privatisation. In the case of China, it has been argued that this has led to a three level set of potential privatisation deals. In the Egyptian case study it was noted that the General Petroleum Corporation and Egypt Gas (the natural gas administration) have not been considered, apart from contracts of limited exploration. The reason was that the oil industry is considered to have a strategic importance, which other industries, such as the telecommunications industry, allegedly lack. Similarly, it was noted that in the oil sector in China, governmental control has remained the norm rather than the exception, due to its overwhelming importance for the future economic growth in the country.

Thus, the nature of the industry in question must be considered in any privatisation deal. Notably, the experiences of other states have already set the precedent for the oil industry which, being a strategic industry, cannot be treated as other less strategic sectors. It is important to keep this in mind, since in the Iranian case the oil and gas industry have been traditionally considered as strategic industries.

However, we should not take this to mean that, because there is a strategic rationale for a particular industry and therefore less possibility for privatisation, there is no potential for change. The Chinese case is a good example of this. Despite the fact that the government has retained more control over the oil industry than over other industries,

transformations have occurred. While, as noted earlier, the example of China is in some ways very different from the Iranian case, it shows that there is always the possibility for other models of economic change in order to make an industry more competitive. Another lesson learned is that political confrontation over privatisation is the norm, not the exception to the rule. Even in China, which has a centralised government structure and an extremely centralised economic system (although on the way to becoming less centralised), there were disputes after the Congress meeting in 1999 between reformists and conservatives. With the former winning the upper hand, local governments started to sell small and medium state-owned enterprises.

The lesson to be learnt here is that regardless of the level of centralisation of a government, privatisation has an innate controversial nature. There is always an inherent conflict between the possibility for a state to transfer economic ownership to private companies, and the possibility for it to guarantee the continuity of specific economic and social policies. Controversy has already dogged Iranian attempts at privatisation, and the recent presidential election made the process increasingly controversial. Yet, there is a bright side to this in that controversy and debate also mean that the issue is discussed and evaluated. Therefore, even in the case that the core of the Iranian government decided not to privatise the industry, there would still be hope for a debate and, out of this debate, a possibility of compromise may emerge. The result could be that potential for parts of the industry are considered for privatisation or, more generally, the prospects for privatisation simply change. In summary, there are four lessons to be learnt from historical precedents, which should be taken into account when looking at privatisation of the oil and gas industry in Iran. Firstly, the timeframe of privatisation will be driven in part by the nature of the model of privatisation chosen. Secondly, perfect rationality cannot be assumed; the government may simply misjudge the context for privatisation and this may have effects on both the nature and outcome of the process. Thirdly, the nature of the industry in question matters; in particular, strategic industries, such as oil and gas, will tend to be privatised differently than other

industries, if at all. Finally, debate and controversy will surround privatisation regardless of the political and legal nature of a particular government. This is a double edged sword, since it tends to slow down the process towards privatisation, making compromises necessary but, at the same time, it also lends hope in instances where the core of the government does not seem to want to privatise.

## **1.8 A Final Note**

This chapter has examined the theoretical and precedent-based boundaries which form the realm of possibility in Iranian privatisation policy-making. As previous sections have demonstrated, these issues will come into play in determining the nature of privatisation policy in Iran and therefore, indirectly, determine, or help determine, the political will of Iranian policy-makers who are responsible for privatisation policy.

The following chapters will attempt to incorporate the empirical information as well as the historical background of privatisation in Iran within these theoretical boundaries. At the same time, it is suggested that this chapter has provided some valuable insight into the overarching question of this thesis, i.e. ‘what are the determinants of privatisation of the oil and gas industry in Iran?’.

## **CHAPTER 2: POLITICAL ECONOMY OF OIL NATIONALISATION AND PRIVATISATION IN PRE-REVOLUTION IRAN**

### **2.1 Introduction**

Most studies of the pre-revolution period focus on theories of the Iranian revolution. They outline the evolution of Iran's political environment during the twentieth century, including its early attempts at constitutional government and subsequent experiences of absolutism under the Pahlavi dynasty (1926–79) (Katouzian, 1981).

Many authors have also analysed the role of key agents, particularly the Shah and Ayatollah Khomeini, in creating the conditions for revolution in the late 1970s. Others have assessed the more structural factors that contributed to the Shah's overthrow, questioned to what extent the nature and experience of the revolution conditioned subsequent political developments, and asked what lessons the revolution holds for the present regime (Katouzian, 1981).

This chapter uses published literature to reflect upon the question of this research, which refers to the willingness of the present Iranian government to privatise its oil and gas industry. In other words, an analysis of Iran's past history will be put to work to outline the most important trends and features of Iranian political and social life, and relate them with the specific oil policies of Iranian governments on privatisation and nationalisation. The chapter also analyses the roles played by the internal and external political and economic actors and events which have affected change in Iran in the past and thereby led to the evolution of today's government.

The question raised in this chapter refers to the reasons behind the Iranian government's decision to nationalise then partially privatise the oil industry. This question will be placed within a broader discussion about the role of internal and external factors

(economic, political, social and cultural) that determined the evolution of the Iranian state. The discussion will thus serve to contextualise the analysis of post-revolution Iranian politics and economics. This chapter explores these issues from World War II, which may be seen as the beginning of modern Iranian history, through to the Iranian revolution in 1979, which may be regarded as formulating the features of Iranian government up to the present.

It will argue that the pre-revolution period is characterised by centralisation of power, nationalistic discourse reflected in the policies towards the oil industry and clientelistic relationships between the main authorities and the business environment. A failed constitutional reform, due to both internal political factionalism and centralisation of power in the hands of the Shah, hindered political and socio-economic reform in Iran. A contradictory relationship with the Western countries (dependence and independence) played an important role in the Iranian political and decision-making process. The relationship was marred by misperceptions (Jervis, 1976), but also nurtured by the inadequate fit between the economic and political interests of the West (specifically of the US) and of Iranian society and government.

## **2.2 Politics Leading up to the Shah**

The aspirations of the founder of the Pahlavi dynasty, Reza Shah, were focused on the development of the infrastructure of the country. This involved the creation of a viable railway system connecting the north to the southern ports, as well as a network of roads across the Iranian plateau in anticipation of making the country independent of foreign power politics. Along with this endeavour, the politics of the country leading up to the time of Mohammad Reza Shah consisted of modernising the military and financial institutions, and the creation of a functioning civil service to cope with the anticipated



income derived from the export of oil. This section will now examine the role of Mohammad Reza Shah and his plans, which aimed to firstly achieve rapid growth and high employment, and secondly to achieve a degree of economic diversification which would result in the more equal distribution of wealth and the creation of a newly awakened middle class.

### ***2.2.1 Key Features of Iran's Political Economy During the First Stages of Economic and Political Modernisation – up to 1953***

From the onset of its modern history, Iran has experienced a desire to politically and economically modernise. These processes were accompanied by an important nationalist discourse, which fitted well with the European discourse on the rights of self-determination (Katouzian, 1981:130-132).

The first stage of the modernisation process can be traced back to the Constitutional Revolution of 1905-06, which brought about an elected assembly. But it was the second stage - initiated in 1925 with the seizing of the throne by Reza Shah Pahlavi, a “ruthless nationalist” (Milani, 1997:80) - that set the foundations of the Iranian oil industry. It was during his rule that Iran became a key oil exporter.

Politically, Iran experienced decentralised political power that was split between a multitude of political actors between 1941 and 1953 (Katouzian, 1981:130-132). Mohammed Reza Shah's court<sup>12</sup> was only one centre of power amongst many, with the Shah himself having little power. This was one of the few periods in Iranian history with many political actors, from political parties to student associations and labour unions, and one promising political freedom.

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<sup>12</sup> Mohammed Reza Shah was the son of Reza Shah, who was installed into power in 1941.

The level of political participation reached a new zenith. New ideological parties were formed, recruiting people from all social classes. Activists published new newspapers, professionals and students formed associations, labour organisers revitalised their unions, and political debate became fashionable and free (Milani, 1997:80).

Besides pluralism of politically engaged actors, factionalism was also a feature of the Iranian political scene. Political factionalism is characterised as the inability of political actors to form coherent and long-lasting coalitions in order to implement policy platforms. It emerges when political parties offering properly articulated positions are suppressed, so that rather than forming a broad coalition to attract mass support, competing economic and political interests pursue power in a clandestine fashion, often by forging unstable alliances between themselves or by attempting to gain influence or favour with the executive power. This kind of political suppression characterised the period leading up to the Islamic Revolution.

Factionalism is reflected in hundreds of fragmented and fragmenting parties (Shafaq, cited in Abrahamian, 1982).<sup>13</sup> Individualism seemed to guide the behaviour of political actors in such a way that made Shafaq notice that deputies behaved as if they were the sworn enemies of the ministers. A major consequence was an unstable political environment.<sup>14</sup>

Abrahamian points out, however, that despite the variety of actors, one can safely argue that overall, a relatively small elite still retained effective control over the political measures to be adopted, due to the lack of an educated middle class politically independent from the palace.

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<sup>13</sup> A British government source from the same period claimed that “No two Persians can ever work together for any length of time, even if it is jointly to extract money from the third party” (Abrahamian, 1982). Stripping away the patronising Foreign Office hauteur and orientalist tone, this may still be an accurate portrait of Iranian political life at the time, although more because of legitimate and rational ideological divisions rather than some endemic fault in the national character.

<sup>14</sup> For example, some twelve Prime Ministers have been installed in the course of thirteen years.

Of the 148 ministers, only fifteen were salaried personnel and modern educated professionals with roots in the middle classes and without links to the palace (Abrahamian, 1982:170).

When a political actor could rally the support of the middle class and the support of the Ulama,<sup>15</sup> power could be obtained and exercised. This was the case for Mohammed Mossadeq, who was elected Prime Minister in May 1951.

Although he and his cohorts constituted a very small faction in the Majles, they relied on public pressure, mass demonstrations by their supporters, and an alliance with several leading ulama to pressure the landlord-dominated Majles to approve their innovative nationalisation plan (Milani, 1997:80).

In spite of his own personal background, which placed him amongst the landowning conservative elite, Mossadeq and his National Front Party put forward a progressive programme (Abrahamian, 1982:189, 269-273) elaborating the 1943 *Majlis* elections. It was aimed at politically further democratising the country, as it proposed removing the Shah's control of the military to prevent a re-run of Reza Shah's dictatorship. It also supported electoral reform to increase the voice of the professional middle class at the expense of the landed families. In terms of foreign policy, he believed that Iran should have avoided granting exclusive economic concessions to individual powers in an effort to buy favours. Politically, Iran should have pursued a non-aligned course. The measure that directly concerns the economic sphere in this study refers to the nationalisation of the main economic sectors.

By 1950, the pre-eminence of the oil industry within the Iranian economy meant that oil nationalisation was a major target. In the same year as his election, Mossadeq

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<sup>15</sup> According to the *Encyclopaedia of the Orient*, ulama is used for "a group of men with religious education and religiously related professions. Ulama is the group of men expressing the true content of Islam towards both the people and the rulers" (*Encyclopaedia of the Orient*, available on-line at [www.Lexicorient.com](http://www.Lexicorient.com)). See also <http://i-cias.com/cgi-bin/eo-direct.pl?ulama.htm>.

nationalised Iranian oil – at the expense of the British oil giant the Anglo-Iranian Oil Company (AIOC) (Personal Communication).<sup>16</sup>

The fact that Mossadeq's reforms led to his downfall speaks volumes about the political Iranian environment, as well as the role of international actors in Iranian politics at that time. Conservative groups, such as the landowners and officers, were still influential and the Shah still reluctant towards institutional reform that could result in loss of control.

The Shah's distaste for Mossadeq's reforms coincided with that of major international actors, such as the US and the UK (Personal Communication).<sup>17</sup> The latter protested about nationalisation by the imposition of an oil embargo on Iranian oil exports. Then, with assistance from the US and British secret services, the military organised a successful coup against the Prime Minister in August 1953. Mossadeq and other National Front leaders were arrested and imprisoned. Mohammed Reza gained full control over the government.

One can conclude that in the first stages of modernisation, Iran had made beneficial attempts to democratise through creating a favourable environment for the political expression of various groups. These measures were, however, countered by the existence of a powerful conservative elite (landowners, military), loyal to the monarchy (i.e. to Mohamed Reza). This translated in resistance to institutional change and political reform. In other words, pluralism was allowed so long as it did not dramatically change the socio-economic and political status quo. Factionalism, as a feature of Iranian political life, contributed to the failure of the progressive programmes put forward by

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<sup>16</sup> Personal communication, discussions with Mr. Hossein Kazempour Ardebili, member of the Board of Governors, OPEC, and Head of the Iran delegation to OPEC, December 2005.

<sup>17</sup> Ibid.

Massadeq. Just as important, international actors had effective constraining mechanisms to influence Iranian domestic political life.

The analysis so far has pointed to some important factors that influenced Iranian decision-making and the design of economic policies with respect to the status of the oil and gas industry in particular. An analysis of the Shah's absolutist rule would suggest that some of the already existing tendencies or features would be consolidated.

### ***2.2.2 External Relations: Building the Perception of the West***

When discussing the determinants of Iran's economic policies with respect to privatisation, one needs to understand the perceptions of the Iranian politicians and wider public towards foreign actors, as privatisation and opening of the Iranian economy creates opportunities for the involvement of the latter. Thus, Iran's external relations, as well as the discourse related to this aspect, become essential to the overall research endeavour. Their emergence and evolution will be built upon throughout this thesis.

Iran's relations with its neighbours and powerful Western nations have always been difficult, resulting from Iran's strategic geographical location, its significant oil wealth and its weakness in comparison to the major Western powers. Although Iran was never directly colonised in the modern era, the extent of Western interference has been significant. Moreover, as Halliday (2003) argues, this atypical "semi-colonisation" experience means that Iran lacks a clear break separating a dependent past from an independent present and future.

The patterns of semi-colonial control used by Britain, Tsarist Russia and later the US - influencing ministers, fostering dissension in the provinces and suborning the military - were

precisely those most likely to engender a conspiracy mentality among Iranians (Halliday, 2003:65).

There is also plenty of material that can nurture the public's perception that Iran is open to interference from external actors, i.e. such actors can have a considerable impact on the country's specific political rule and policies, especially with regard to the oil industry. Incidences of British, Russian/Soviet and American interference included the secret Anglo-Russian Agreement (a plan to partition the country into zones of influence) exposed in 1907, the 1915 agreement between the two countries (known as the Constantinople Protocol) that implied the dismemberment of Iran, the 1919 Iran/British Agreement that forced Iran to employ British advisors at its own expense, the involvement of British military officers in the 1921 coup that installed the Shah's father as ruler, the 1933 Oil Agreement which Iran signed up to under British pressure, the 1941 Anglo-Soviet invasion and, of course, the British/US-sponsored coup against Mossadeq in 1953. The above meant, perhaps unsurprisingly, that:

...there has seldom been any significant (major as well as minor) political event, which... a large section of the Iranian public has not believed to have been planned and executed by foreign powers through their Iranian agents (Katouzian, 2003:118).<sup>18</sup>

However, it is interesting to note that the conspiratorial view of outsiders only emerged during the modernisation stages. The traditional, historic view of Iranians has certainly been different. Katouzian makes the point that:

Up to a century and a half ago hardly anyone attributed perceived injustice to the machinations of western powers or

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<sup>18</sup> Katouzian goes on to note, however, that in most cases substantial involvement by Iranian forces or miscalculations on the Iranian side played a significant role. Nevertheless, even the Shah eventually came to believe that he was the victim of a malign foreign (CIA) plot: "the Shah... fell back on the old Iranian formula of seeing Iranian politics as some kind of vibration elicited by foreign players" (Zonis, 1983).

their paid Iranian agents. But since then, because of the growing weakness of Iran vis-à-vis imperial powers, almost all injustice emanating from arbitrary states was attributed to imperialism (Katouzian, 2003:29).

One could say, however, that besides the actual facts that may justify the belief in the negative role of the external actors, misperception also played an important part. In other words, this perception goes beyond objectively verifiable facts concerning Western involvement and has tended to bias the Iranian perception of the West, including both the public and policy-makers, in its relations with the West.

### **2.3 Mohammed Reza Shah's Rule**

On 25 August 1941, the 21 year-old son of Reza Shah, Mohammad Reza Shah Pahlavi, was installed to the Peacock Throne by the Allies (Pollack, 2004). He inherited a country which was occupied by British and American forces in the south and Russian forces in the north. The German invasion of Russia, in June 1941, brought Stalin closer to Churchill, and also coincided with the British Navy starting to convert from coal-burning engines to fuel-driven propulsion. By this time, Reza Shah's regime had seen the completion of the Trans-Iranian Railway linking the ports of the Persian Gulf to the Caspian Sea. Consequently, it was not surprising that the Allied forces occupying Iran would want to use the networks which were in place to supply the Russian troops in their fight against the German army in Russia.

The new Shah remained mostly in the background at the beginning of his reign. His ambition was to consolidate his internal base of support, get closer to the American administration, and to start to behave as more than just a figurehead monarch. Perhaps his biggest ambition was to build a modern Iran strong enough to compete with and stand up against the dictat of European powers which wanted to direct how he should

run Iran (which his father had instilled into him). It is perhaps ironic to see that, at the end of his rule in 1978, the revolutionary crowds were chanting slogans against him for having sold Iran out to these western powers.

### ***2.3.1 The Features of the Regime: Centralised Power, Clientelism, Factionalism and Arbitrary Rule***

The reinstatement of the Shah to the detriment of constitutional rule represented the beginning of a strongly centralised military dictatorship (Owen, 2000:92). Any opposition foci were annihilated, including the leading leftist, Tudeh and religious leaders - the military executed forty of its officials over the next four years (Abrahamian, 1982:280). In 1964, Ayatollah Ruhollah Khomeini was expelled by the government.

Sensitive to the external forces, such as the US which pressed for liberal reforms, the Shah attempted to reform the political system in 1958. The two-party system was abandoned in 1964 when the parties were dissolved and the *Iran Noveen* party was created in their place (Milani, 1997:80). In 1975, he created the *Rastakhiz* (Resurgence) Party, “a mass organisation to which all of Iran’s bureaucrats and persons of influence and importance were first encouraged, and then forced, to belong” (Ibid.).

However, all parties were “totally subservient to the monarch, and lacking any integrity” and, as a result “failed to attract any significant portion of the population” (Ibid.). The creation of government-sponsored trade unions by the secret service and integrated traditional systems of local governance - such as village headmen (Owen, 2000:93) were also part of the same attempts to superficially diversify the political scene.



However, these artificial attempts to create a diverse and independent political life were unsuccessful due to the compulsive drive of the Shah to exercise full control of power through undemocratic measures.

Clientelism became a feature of the political system, alongside the centralisation of power through violence. This feature, built of course on the existent system of privileges 'bestowed' upon the conservative property-owning classes even before the Shah's authoritarian rule.

The state has not been representative of the higher social classes; on the contrary, they have been its clients by virtue of the privileges it has bestowed upon them (Katouzian, 2003:29).

To this, one must also add a long standing disjunction between the larger society and the state. The relationship between the state and society was considerably different from that established in Western states. The idea of a social contract between the state and society was never the driving force in the organisation of Iranian society. Thus, the Iranian state's legitimacy was not enforced or maintained through the ability to link with society. It was rather an 'arbitrary rule' and decision-making process, whose authority was not necessarily based on law (see also *Ibid.*, chapter 1).

The latter features of the relationship between the Iranian state and society can successfully account for the type of solidarities that are created in times of social upheaval. Katouzian argues that a consistent theme in Iranian revolutions and revolts is an attempt to overthrow an unjust ruler and establish non-arbitrary government. Because the unjust ruler does not represent any particular social group or groups, when the revolt occurs it will unite, rather than split, society.

The constitutional revolution of 1905–09 and the revolution of February 1979... shared the basic features of traditional Iranian

revolts inasmuch as they were aimed at the overthrow of the state - indeed the person of the ruler - at all costs, they had the support of the entire political society, and they were not resisted by any social class (Katouzian, 2003:31).

As will be discussed later, the widespread support for the revolt against the Shah during 1977–79, the inability of the secular leftists and conservative clerics to make a common cause, as well as the move towards the appropriation of power through the destruction of the opposition after the revolution, can be seen as a reflection of this structural problem of Iranian society.

As mentioned earlier in this chapter, factionalism was specific to Iranian political life, having an even greater impact in post-revolution Iran. Yet, oddly enough, this feature emerged to the surface even in the authoritarian regime of the Shah. The *Rastakhiz* party developed into an embryonic pluralist system. There was some ability for communication to come from the bottom upwards. The party developed two opposing ‘wings’, which offered slightly different slants on the official position. As Zonis (1983) documents, the party soon became more than an establishment patsy:

...it began to offer the possibility for communication, not merely from the top down, but also from the less to the more powerful. ‘Wings’ of the party were created... offering slightly different and legitimate perspectives. Increasing numbers of the politically literate began to believe that the formation of these wings offered, finally, hope for political democratization (Zonis, 1983:598).

This trend created some hope for democratisation but the structural authoritarian regime dashed it by banning competition between the two wings of the party in the *Majlis*, shutting down the party in 1977. This was a serious mistake:

By the end of 1977... just when revolutionary fervour elsewhere in the society was being translated into revolutionary action – the only national organisation capable of providing

political support for the regime was undone. ...The economic and political processes which resulted in feelings of betrayal and frustration were significant sources of the revolutionary energy that culminated in the overthrow of the Shah (Zonis, 1983:599).

The repression of all independent sources of power or ideas was the guiding rule of the regime (Milani, 1997:80).

## 2.4 External Relations

The terms of the relationship with external actors continued to follow the same trajectory during the Shah's time as it did before his authoritarian rule; actual interference by the Western governments, or the need to find a scapegoat for the structural problems of Iranian economy and political life, further constructed the anti-Western discourse (Personal Communication).<sup>19</sup>

At crucial moments, foreign intervention interacted with domestic factors to determine the scope and direction of Iran's political development. British and US involvement in the 1953 coup against the nationalist politician Mohammed Mossadeq (for his nationalisation of British oil interests in the country) put an end to an emerging pluralist political culture (Zonis, 1983:603; Katouzian, 2003:119). Later, pressure from the Kennedy administration to undertake liberalising reforms led the Shah to implement his 'white revolution', a general programme of policy reforms focusing in particular on land redistribution. The policy backfired by alienating the Shah's supporters amongst the large landowners and upsetting even those who approved of the direction of policy but disliked the foreign interference. Some commentators also argue that the Carter

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<sup>19</sup> Personal Communication. Discussions with Seyed Mohammad Hossein Adeli, former Iran Ambassador to the UK and present editor of *Economic Trends*, Tehran, February 2006.

administration's calls for liberalisation undermined the Shah's ability to combat the growing insurrection from 1977 onwards (Owen, 2000:92).<sup>20</sup>

The Shah's complex relationship with the West in general, and the US in particular, is widely perceived as being of central importance in explaining both the evolution of his rule and his eventual downfall. It has been argued that "during the 1950s and 1960s, the United States – either through direct suggestion or judicious innuendo – could influence the Shah's behaviour and make him carry out American-inspired policies in Iran" (Zonis, 1983:604). However, the Shah's government also enjoyed close relations with non-Western countries.<sup>21</sup> The fact that he had a quite dependent relationship with the US, for example, corroborated with the failure of his attempts to reform a repressive system, played an important role in constructing the anti-Western discourse within the opposition and society.

Thus, nationalistic, anti-US rhetoric proved a critical ingredient in the appeal of the anti-Shah forces in the late 1970s. The revolution "was felt to be a nationalist movement against the political, economic and cultural influence of the West, and of the United States in particular" (Halliday, 2003:64).

There were certainly imperial ambitions by Western powers concerning Iran and these ambitions were played out in the internal politics of Iran. Nonetheless, arbitrary rule cannot be blamed completely on imperialists, though the public might like to do so.

Imperialism was real enough but it did not create the arbitrary system of government in Iran, although it clearly did what in

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<sup>20</sup> As Zonis discusses, the Shah even believed that the CIA was behind the emerging unrest in the 1970s, falling back "on the old Iranian formula of seeing Iranian politics as some kind of vibration elicited by foreign powers" (Zonis, 1983:595).

<sup>21</sup> He was also supported by the Soviet Union and China (the Shah's last state visit was to Beijing) (Zonis, 1983). However, it was his relationship with the West which had the greatest effect on society.

the circumstances it thought would serve its interest best (Katouzian, 2003:29).

Nevertheless, whether or not imperialism was real is irrelevant; more important was the existence of the perception itself, which influenced Iranian politics and policy-making. This factor will repeatedly come up in the analysis of subsequent eras of Iranian politics. Therefore, it is to be counted as one of the major determinants of Iranian policy-making and, as will be discussed in more detail later, as one of the major determinants of Iranian privatisation policy. This perception has not been the same with respect to all the other Western powers. It is interesting to note that despite, for example, the UK's involvement in Iranian politics along its history, the reluctance towards the West was mostly portrayed as originating due to the interactions with the US. Consequently, the policies of the Iranian government were targeted in relation to the political and economic effects they had on the US (Personal Communication).<sup>22</sup>

The history of external interference helped to foster the "conspiracy mentality" which Khomeini played upon (Halliday, 2003:63).<sup>23</sup> It has influenced not only the overthrow of the Shah but also the subsequent policy-making (i.e. the course of possible economic and political policies) and the attitude towards foreign investors and privatisation.

## 2.5 Economics Under the Shah

Shah Mohammad Reza Pahlavi acceded to the throne in 1941 amidst foreign occupation, economic disintegration and multidirectional attacks on his father's 20 year rule (Zonis, 1971). His main focus was to consolidate popular support and admiration

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<sup>22</sup> Personal Communication. Discussions with Seyed Mohammad Hossein Adeli, former Iran Ambassador to the UK and present editor of *Economic Trends*, Tehran, February 2006.

<sup>23</sup> Abrahamian (1991) quotes a number of Khomeini's anti-Western slogans from the time of the revolution. The dictum "the oppressed nations of the world should unite against their imperialist oppressors" gives a flavour of their tone and content.

by propagating rapid growth, supplemented by high employment and supported by comprehensive public welfare services as a means of achieving distributional equity (Amuzegar, 1999). The reform and economic programmes throughout his rule were aimed at winning the backing of the masses and, to this end, his aspiration was to develop the non-oil based industry in the country, whereby Iran would not be so dependant upon the revenue generated from the sale of oil and petrochemical products. His economic diversification started with his decree for land reforms during 1961-1962. The Shah called the programme the 'White Revolution' (Enqelabe-e Sefid), having the aim of gaining the support of people in the rural areas and turning the farmers into stakeholders within their farming communities. This programme attracted the support of the American administration and his American-backed Prime Minister at that time, Ali Amini (Saikal, 1980). The plan, which initially looked noble in its intention of closing the gap between the land owners, the political elite, the small number of industrialists and the mainly agrarian population, turned out to be ill-conceived and short-lived. Despite extensive American aid and increasing oil revenue, by the mid-1960s the Iranian economy was not in a sound position. The inequality of incomes was increasing and the urban population's standard of living, not to mention that of the rural people, was not achieving the expected results. Corruption was widespread throughout the administration by the mid-1970s and Iran continued to remain one of the world's most slowly developing countries, with a illiteracy rate of around 85%.

The distribution of shares in assembly plants, which were touted to be major production units, attracted the farmers from the rural communities into the population centres of the country. Inflation, due to shortages, rose to all time highs during the years preceding the revolution. The lack of research and development in the production units and industries erected by those who were close to the Shah and his immediate family, which were the symbols of progress for the Shah and his cronies, meant that they were ill-equipped to compete with the vast quantity of imports.

In the sections to follow, this study shall examine other aspects of the programmes and policies that the Shah adopted to develop the foundations of a sound economy. However, as we shall see, they caused yet further alienation for him amongst the very people whom he intended to bring prosperity and living standards equal to those in Europe.

### **2.5.1 Oil – Reversing Nationalisation While Keeping Control**

Oil has been the cornerstone of the Iranian economy and consequently the most important economic decisions concerned the regulation of the industry. However, due to the importance of the resource for the industrialised world in general and the specific linkages developed with British and American companies, these decisions were never purely economic. Politics was an important part of the decision-making game (Personal Communication).<sup>24</sup>

In the history of the oil industry, the Shah's decision to reverse the nationalisation of the oil resources (i.e. the annexation of oil assets), is an important one. His signing of the Consortium Agreement – based on a 50-50 profit-sharing principle – which Mossadeq had rejected, signified that these decisions were not impossible, but were largely dependent on the broader political environment. One must remember that the Shah's regime was heavily supported by the US (Nazmi, 1989:43). Iran came to serve as a stable source of cheap oil for the West. However, the dependence of the Iranian economy on oil exports, especially in the 1970s, led to it becoming a dependent capitalist state (Ehteshami, 1995).

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<sup>24</sup> Personal Communication. Discussions with Seyed Mohammad Hossein Adeli, former Iran Ambassador to the UK and present editor of *Economic Trends*, Tehran, February 2006.

Oil allowed for significant development within Iran. Increasing global demand for oil was the key motivating force behind Iran's economic development, providing both the funding and the rationale for much of the country's rapid industrialisation under the Shah. Total oil revenues between 1964 and 1974 stood at US\$13 billion. Revenues between 1975 and 1977 alone were almost triple this figure (Abrahamian, 1982:427). This growth in revenue was fuelled by the drastic increase in oil prices in 1973-4.

### **2.5.2 *Relations Between the State and Capitalists***

It was obvious to the Shah that control of the oil industry was key to controlling the country's most important source of revenue. Thus, despite the agreements with the Western companies, the Shah tried to use his position of control domestically to further consolidate his regime (Personal Communication).<sup>25</sup>

Clientelism remained a key feature as previously, not only of the political realm but also the economic one. The state's control over the oil resources fostered an unhealthy relationship of dependency between capitalists and the state (Nazmi, 1989:41-2). The Shah instituted an intensive capitalist development in Iran which involved an expanded role of the state in the economy through being both interventionist and orchestrating (Ehteshami, 1995). Private accumulation was possible and there were entrepreneurs, especially in the areas of a few highly profitable industries such as construction. However, they were dependent on state "hand outs" (Ibid.:80), since the state which had a monopoly control over oil was the "fountainhead of capital accumulation"

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<sup>25</sup> Personal Communication. Discussions with Seyed Mohammad Hossein Adeli, former Iran Ambassador to the UK and present editor of *Economic Trends*, Tehran, February 2006.



(Ehteshami, 1995:78). This monopolistic control further contributed to the autonomy and supremacy of the state in relation to society.<sup>26</sup>

Control over oil revenue allowed the Shah to further distance himself from society. As the oil revenue grew from the mid-1970s, the Shah could increase the country's military budget and reduce its dependence on foreign assistance. In turn, this permitted further centralisation of power and, as mentioned, ultimately distanced his rule from society. He began to focus almost exclusively on foreign, economic and military issues, to the detriment of internal political issues (Nasri, 1983:623).<sup>27</sup>

In particular, much of the state's money went towards military purchases. Under the Shah, Iran's armed forces grew exponentially (Nazmi, 1989:52). It has been noted that for every \$1 earned in oil exports to the US, Iran imported \$2 worth of military equipment during the 1970s.<sup>28</sup>

Moreover, genuine private sector development was undermined because the members of the capitalist class, created and nurtured by the Shah's development policies, were able to compete unfairly against other, less favoured, entrepreneurs. In Katouzian's words:

[These] were people who, often with relatively little capital of their own, acted as little more than agents of the state

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<sup>26</sup> There were specific changes in the economy during the Shah's rule which reinforced this autonomy and supremacy of the state combined with a capitalist class. In the aftermath of the 1953 coup, the Shah abandoned import substitution policies, shifting to a less protectionist stance that generated a substantial trade deficit and hit domestic producers hard (Nazmi, 1989). As domestic producers withered in the face of fierce competition, state investment increasingly substituted for private sector development, rather than aiding it. Following a severe recession and balance of payments crisis in 1960, import restrictions were imposed as part of an IMF-led austerity programme (Ibid.). The government augmented the IMF-imposed measures with restrictions of its own that essentially saw Iran returning to the classic import substitution path to development. As ever, it was financed through the economic rents earned from oil.

<sup>27</sup> Ironically, the Shah's military build-up and forays into the foreign policy world "estranged many foreign leaders" (Nasri, 1983:624).

<sup>28</sup> Arms dealers "began to jest that the Shah read their manuals in much the same way as other men read *Playboy*" (Abrahamian, 1982:436).

empowered to use public funds, and other privileges, for supplying assembled [products] (Katouzian, 1981:278).

The above phenomena brought “modernisation in form”, but it actually “spread... underdevelopment to the very pillars of the economy” (Nazmi, 1989:42). It proved that economic measures (despite relaxed relationships with foreign companies) cannot determine genuine development due to the continuous political interference from the state. Clientelism and authoritarian rule undermined healthy economic relations. They eventually led to the state becoming the centre of Iranian economy. This was reflected in the fact that, by the 1970s, the state was providing 70% of the total investment funds in the economy (Ehteshami, 1995). The ‘private’ sector was largely under the control of only 45 families who commanded 85% of the larger privately held firms (Ehteshami, 1995:81). One could say that the positive aspect of the existence of a ‘capitalist’ layer in society, which was profit-oriented, was overshadowed by the mechanisms that determined the relationships between the state and the business community, i.e. clientelism and arbitrary rule. Additionally, the focus on military expenditure, determined by a desire to assess Iran’s power within the international arena as well as domestically, drained resources that could have been allocated to other sectors of the economy.

### **2.5.3 *State of the Economy***

This is not to say that the Iranian economy was in a bad state. In fact, judging from macroeconomic aggregates, economic policy seemed successful under the Shah. Real output grew by around 7.5% per year on average during the 1960s. Between 1965 and 1973, average real output growth stood at more than 10%. Indicators such as the infant mortality rate and life expectancy also improved (Nazmi, 1989:40). The state played an active role at every level of economic development – from the construction of massive

dams to provide power and feed irrigation schemes to the provision of subsidised industrial credit and fertiliser (Abrahamian, 1982).

Overall, the Shah's economic policies brought little substantial or lasting benefit to Iran.<sup>29</sup> The impressive output growth reflected primarily the exponential growth in oil revenues, much of which was wasted on military hardware, state bureaucracy, corruption and inefficient investment. The channelling of oil revenues into the productive sector via state support and subsidised lending policies may have been more damaging than simply throwing the money away on military hardware (Nazmi, 1989). The investment was clearly unproductive, if we take productivity as being to some degree dependent on diversification, as the economy wholly failed to diversify out of the oil sector. Inefficient allocation of capital led the economy down a false development path, squandering scarce resources and undermining potentially more efficient producers. As a result, by the time the Shah was deposed, oil revenues accounted for 40% of national income and almost three-quarters of the government's revenue (Nazmi, 1989:51). Iran's non-oil income per capita was lower than that of many countries generally considered much poorer - "hardly appropriate for an economy the Shah named 'the new Japan'" (Ibid.). As with politics, there were some attempted economic reforms under the Shah.

#### ***2.5.4 Attempts at Economic Reform***

Rapidly accelerating inflationary pressures, in response to the oil boom, prompted the authorities to engage in a disastrous programme of price controls and "anti-profiteering

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<sup>29</sup> However, Abrahamian takes a less damning view, arguing that, although "substantial sums were squandered on palaces, royal extravagances, bureaucratic consumption, outright corruption, nuclear installations and ultrasophisticated weapons too expensive even for many NATO countries" (Abrahamian, 1982:427), much of the oil wealth was channelled into more productive uses.

courts” (Zonis, 1983:596).<sup>30</sup> These courts in particular cost the Shah the support of the business community, and also stoked fears of sectarianism, as many of the businessmen accused of price fixing were members of minority communities (Jews and Baha’is) rather than Shiite Muslims.

The Shah’s key economic policy initiative was the so-called ‘White Revolution’. This initiative, launched in 1962 in response to the economic crisis of 1960 and pressure for liberalisation from Washington, had at its heart an extensive programme of land redistribution (Owen, 2000:92-93). This reform programme was symptomatic of the Shah’s broad-brush approach to economic development. Motivated by a mixture of good intentions, hubris and an obsession with modernisation, and suffering from a total lack of attention to detail, the reform eventually alienated both the traditional landowners and the peasants who were supposed to be its main beneficiaries.<sup>31</sup>

The anti-inflation policies were also wholly ineffective, since the only long-term remedy to the accelerating inflation of the period - proper monetary discipline - was ignored. “The price controls... only led to shortages and the creation of black markets” (Nazmi, 1989:50). These failed economic reforms, like the failed political reforms, only contributed further to the fall of the Shah in 1979. However, behind these failed reforms were deeper tensions concerning Iran and development that can be traced up from the Shah through the revolution.

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<sup>30</sup> Some 8,000 businessmen served prison sentences of up to three years, and 250,000 fines were issued (Abrahamian, 1982:498).

<sup>31</sup> As Owen observes, the reform tried to force peasants into collective farms, creating a “legacy of bitterness that... meant that the regime lost all possibility of obtaining political support from the direct beneficiaries of the reform” (Owen, 2000:93). The White Revolution also alienated the clergy, who were significant landholders (Nazmi, 1989). This group also objected to the extension of women’s rights and literacy projects that were included in the reform programme.

### **2.5.5 *Social Tensions Caused by Development***

The social tensions faced by the Shah in his attempt to reconcile the competing demands of the dire need for economic development, the drive to create broad-based development and the need to reconcile development with a socially conservative climate, are discussed in several studies of the Iranian revolution (Nasri, 1983). These tensions continued in the following decades. The politics in the revolution periods would be marked by them.

The Shah's authoritarian policies focused heavily on economic development, neglecting – according to most observers – political reforms that would have promoted a more equitable development path and reconciled competing social and economic imperatives. Saikal, for instance, argues that the Shah's development programme lacked:

a governmental system that would allow increasing political and economic decentralization, public participation, and individual initiative, and thus put more stress on social development and progressive redistribution of wealth (Saikal, 1980:203-204).

Nasri points to the growing social dislocation caused by the rapid pace of economic development in the 1970s. However, he argues that it was this friction between economic and social/cultural imperatives (which affected all classes in Iranian society), rather than the disjunction between growth and broad-based development (which primarily affected the poor), that created the widespread hostility to the Shah's rule:

It was... not the lack of emphasis on economic 'development' as against economic 'growth' that was the source of the problem...; rather, it was the rapid and uncontrolled rate of development that not only made Iranians feel like aliens in their own country, but also increased their expectations to such levels that the government could not have satisfied them even under normal circumstances (Nasri, 1983:619).

Zonis (1983) cites evidence that the perceived inequity of the Shah's development programme was critical in creating opposition to his regime. He follows Walton (1986) in citing Hirschman's (1973) analysis of the effect of development and inequality on the political process. Walton (1986) argues that expectations of ever-rising material wealth were becoming increasingly frustrated and the people's tolerance for the continually rising social and economic inequities was becoming rapidly exhausted.

Zonis argues that the "politicization of income inequality" was a key development of the second half of the 1970s, driven by a "panic over what were seen as disappearing opportunities for riches, and bitter envy directed at those who had already succeeded" (Zonis, 1983:597). Halliday (2003:50-53) shares this perspective, citing the significant increase in income inequality, which saw the urban poor in particular fare badly, as a key factor behind growing opposition to the Shah's regime.

## **2.6 What the Fall of the Shah says about Iranian Society, Political Life and how it Impacted on Economic Policy**

The dramatic collapse of the Shah's regime in 1979 appeared to catch most observers off-guard. Zonis notes that:

The breathtaking speed of the final denouement caught not merely the Shah and the Americans off-guard; Ayatollah Khomeini himself had no idea of the speed with which the Pahlavi system would collapse in those final weeks (Zonis, 1983:602).

However, the inconsistencies and weaknesses undermining the Shah's autocratic regime had been apparent for some time.

For the purposes of this study, the historical events are relevant in so much as they inform our analysis on what are the determinants of Iranian policy with respect to its oil and gas industry. In other words, what is the dynamic within Iranian political life and society that brought revolutionary change? Additionally, what are the economic factors relevant to the revolution and vice-versa, and how would the revolution and the revolutionary discourse impact on the economic policies?

Fred Halliday, one of the most reputed specialists on the Iranian revolution, identifies several key reasons that led to the Shah's overthrow (2003:50-67). Firstly, the rapid and uneven pattern of economic development increased inequality and left many bewildered at the rapid pace of change. This is also a point made earlier by Nasri (1983:619) about the alienation of Iranians due to rapid growth and their dissatisfaction due to increased expectations. Worse, the drop-off in economic performance at the end of the 1970s and the growing evidence of waste and corruption cemented peoples' impression that they had missed their chance for individual material progress.

When it became obvious in mid-1975 that the boom was slowing down, there was panic over what were seen as disappearing opportunities for riches, and bitter envy directed at those who had already succeeded (Zonis, 1983:597).

It was a tension determined by uneven development and an unfair one due to clientelistic relationships. Furthermore, there was the tension between the mechanisms of the authoritarian regime and a modernisation process in the economy.

The Shah was pursuing a capitalist-oriented process of socio-economic development [that] ...unleashed forces opposite to those the throne required for its centrality in politics (Saikal, 1980:203).

As early as 1960, a US government report on Iran, prepared for the newly-elected President Kennedy, identified the Shah's core problem:

Under the Shah, Iran has made considerable progress in economic development, in social welfare, and in internal security and administrative efficiency. The progress has, however, taken place without participation in the government by the main opposition groups. To some extent, the Shah's isolation from these groups has been due to his unwillingness to ride demagogic issues appealing to the lower popular passions. ...To an equal extent however, it has been due to his unwillingness to listen to critical advice, to his unwillingness to share power, and to his near-obsession with military affairs (Zonis, 1983:587).<sup>32</sup>

These conclusions are just as true when discussing the fall of the Shah's regime in 1979.<sup>33</sup>

While there was considerable economic development under the Shah and there were even attempts at political and economic reform, the Shah's ability to rely on oil money and external backing allowed him to ignore domestic issues and dismiss the views of the opposition. The lack of involvement of other parties in government eventually led to the Shah's downfall. Halliday (2003) identifies the broad nature of the political coalition ranged against the Shah as a key cause of his overthrow. This point is reinforced by Katouzian, who argues that the 1979 revolution:

...shared the basic features of traditional Iranian revolts [in being] aimed at the overthrow of the state – indeed the person of the ruler – at all costs, [having] the support of the entire

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<sup>32</sup> Quoted from report by John W. Bowling, Deputy Director of the Office of Greek, Turkish and Iranian Affairs.

<sup>33</sup> In fact, most commentators on the Shah have echoed these comments, even up to the present day. Milani (1997), for instance, argues that the Shah "wished to be the king of a modern country, but he was determined to rule using a medieval system of governance. That is why he modernised the economy but failed to do the same for the political realm". Essentially, the Shah's political failure lay in his inconsistent visions of his own role and his country's. As a result, he was unable to appreciate that the economic and social reforms he sought rendered his own role as a 'medieval'-style autocrat untenable.



political society [and] not [being] resisted by any social class  
(Katouzian, 2003:31).

To an extent, the breadth of the coalition illustrated the naivety of some of those involved – particularly secular and liberal forces, who underestimated the power of the clergy. Thus, despite a mismatch of objectives, the liberal and secular forces had hoped to steer the unfolding of the revolution towards their own objectives.

Among the secular and middle-class forces many hoped that... they could deflect the movement away from its clerical patrons. This enabled such people to support the movement with appropriate optimism, but it represented an underestimation of the strength of the religious forces (Halliday, 2003:56).

The mobilising role of Islam and its personification in the charismatic persona of the Ayatollah Khomeini himself was also critical to the revolution's success. "Khomeini was in many respects the epitome of a charismatic leader" (Halliday, 2003:61). He was also a skilful political operator – able to play to different audiences and broaden his message – which explains in part why the broad anti-Shah coalition was maintained as long as it was.<sup>34</sup>

Finally, Halliday cites the ambivalent international context which allowed Khomeini to portray the Islamic Revolution as a nationalist movement in opposition to the West and the US (the Shah's patrons). The history of external interference – detailed in the previous section – helped to foster the "conspiracy mentality" which Khomeini played upon (Halliday, 2003:63-67).<sup>35</sup> The US' change in tone and direction under Carter's

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<sup>34</sup> Khomeini succeeded in mastering populist rhetoric that helped to soften his Islamist message. As Owen notes, he was: "...a master of a type of populist rhetoric, with its emphasis on such central themes as anti-imperialism, democracy and social justice, that seemed to provide a consensus around which all opponents of the Shah could come together" (Owen, 2000:94). This point is made more forcefully by Abrahamian (1991:106), who argues that "we should recognise Khomeini-ism as a specifically religious variant of populism".

<sup>35</sup> Abrahamian quotes a number of Khomeini's anti-Western slogans from the time of the revolution. The dictum "the oppressed nations of the world should unite against their imperialist oppressors" gives a flavour to their tone and content (Abrahamian, 1991:114).

presidency – pressurising the Shah to liberalise when his regime faced its greatest threat – was perhaps the final straw, particularly taken in tandem with the economic downturn which hindered the state’s distribution of oil revenue to buy political favour.<sup>36</sup>

The Shah’s fall outlined several important aspects of Iranian politics and social dynamics. Firstly, it showed that development does not necessarily create beneficial effects when not accompanied by democratic political reform. Clientelism and authoritarian rule impede fair and even accumulation of wealth, as well as implementation of consistent economic measures. Thus, while Massadeq’s reforms to nationalise the oil industry, for example, alienated some groups of the society, the more relaxed economic agreements with respect to the oil industry did not create a more favourable environment. This was due to the fact that the administration of the country’s revenue from oil was undertaken by an elite who, when they did not use it for the growth of their own businesses, invested in military hardware and used it to consolidate their political power.

Other specific reforms, such as the land reform, failed due to a combination of discretionary measures (e.g. to put farmers into collective farms against their will) and opposition from the conservative groups within society (landowners, clergy) (Personal Communication).<sup>37</sup> The conservative elements proved to be important in voicing the discontent with the regime. The fact that the revolution could rally considerable support through use of a nationalistic and anti-Western tone is essential in understanding the shifts in the economic policies with respect to privatisation in Iran. It is also salient for understanding the type of political culture present at the time in Iran. It actually points out that Iran was at that stage a largely ‘traditional society’, where politics was

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<sup>36</sup> Nasri (1983) comments on this issue in more depth, quoting a number of authors in arguing that Carter’s policy towards Iran confused the Shah, held up the sale of riot control equipment and gave succour to the opposition.

<sup>37</sup> Personal Communication. Discussion with Dr. Manouchelir Lighrani, M.D., former landowner, Tehran, December 2004.

dependent on the skills and charisma of the ruler/leader rather than on the effectiveness of the institutional framework.

However, it must also be taken into account that the revolution fundamentally changed the political and economic functioning in Iranian society and therefore the determinants of policy, including the policy concerning privatisation. Therefore, the next chapter will address the changes in Iranian politics and economics.

## **2.7 Conclusion**

There are several issues which this chapter has discussed that are essential to understanding the interactions between the political, economic and social structures in Iran. This chapter identified authoritarian rule based on discretionary measures as one of the features of Iranian political life. From this, clientelism and uneven development due to a disinterest in society, characterised the economic interactions within the state and the distribution of wealth.

The troubled relationships with Western actors, as well as the need to find a scapegoat for structural economic problems, nurtured an anti-Western and anti-American feeling and discourse, combined with a nationalistic tone, within society and some of the political sphere. This particular attitude will prove to be extremely relevant to the policy design of post-revolution Iran.

The fact that oil was the cornerstone of the Iranian economy transformed its control into a political tool used not only by the Shah but also by the revolutionary regime. In the case of the former, by centralising power, the Shah became the only individual who could possibly make decisions concerning oil and gas privatisation. Since control over oil profits and pleasing foreign backers was necessary, there was little chance of a

change in attitude towards privatisation. In other words, while the Shah partially privatised oil, he retained control of its profits (minus those going abroad) and due to the Iranian economy's dependence on oil, this allowed the Shah to effectively control the economy and bolster his political power. His need for self-affirmation in the international realm as well as domestically, determined an overspending in the military sector to the detriment of other sectors of the economy. Broader international economic developments, i.e. the oil crisis and then the subsequent drop in oil prices, affected the economic development at home. It deepened the discontent within Iran and created an environment for the revolution movement.

The next chapter will move on to address the immediate post-revolution period. It will pay special attention to the continuing factors which have determined policy in Iran. These factors include the relations with and perceptions of the West and the US, the tension between economic and social development and modernisation; and the relations between the Iranian government and the people, specifically in the form of arbitrary rule. The chapter will also begin to address new issues which were factors in the cause of the revolution, but which came to be major determinants for the direction of Iranian society and political and economic policy. Specifically, these have been the role of religion in Iranian society, especially in relation to economics, and the role of the revolutionary ideology in determining domestic and international policy and relations.

## **CHAPTER 3: POLITICAL ECONOMY OF OIL POLICY: 1979 TO 1989**

### **3.1 Introduction**

The analysis so far has shown that there are several relevant issues needing to be considered in order to understand the interactions between the political, economic and social structures in Iran. These include the existence of an authoritarian regime, based on violence and clientelism to support itself, reduced interaction with society and the just mentioned clientelistic relations, which favoured particular groups and affected economic interactions within the state and the distribution of wealth.

The focus on economic modernisation without deep political reform alienated even more different sections of Iranian society. At the same time, good intentions (such as land reform) failed due to undemocratic impositions and opposition from the conservative forces within society. The conservative elements (clergy and landowners) proved to be important in voicing discontent with the regime. They also rallied against the regime's societal groups (such as students) which had quite different priorities. The unifying element was the nationalistic and anti-American tone, and a type of deeper tradition of contestation within Iranian society of groups in power (see section 3.2.2.3 for further discussion on factionalism). The fact that society responded to the charismatic figure of the Ayatollah Khomeini points to the existence of a largely 'traditional society', where politics is dependent on personalistic qualities rather than on the effectiveness of institutional mechanisms.

As to the oil industry, it must be said that it had been largely politicised. Oil was used as a political tool by both the Shah and the coming revolutionary regime. Being the main source of revenue, it became obvious that its control enhanced political control at home, as well as possibilities of self-affirmation internationally. International factors, actors

and events, were also important in creating the overall picture within which Iranian decision-making took place.

This chapter analyses the post-revolution period between 1979 and 1989, along the same coordinates as the previous chapter. During this period, we see the major post-revolution changes in Iran, specifically in its economic system, taking shape. It seeks to answer the question of why the oil and gas industry was nationalised in Iran after the revolution and how the nature of privatisation in Iran evolved and changed over time. It focuses on the political forces which determined economic policy and vice versa in order to answer this question. Firstly, it details the nature of political change in Iran. In addition, Khomeini's political views will be examined in some detail, as will the competing political constituencies. These factors, combined with a look at the major foreign policy issues faced by Iran, give the contextual background for Iran's economic decision-making. The second section of this chapter will examine the economic policies of the post-revolution government and developments within the economic system.

The Iranian revolution was not just a political revolution, it was an economic one as well. The revolution heralded an entirely new relationship between society and government. In particular, the clergy adopted a much larger social role. Khomeini's politics walked the line between fundamentalism and populism. This was also true of the economic sphere, where traditional Islamic economic ideals were mixed with populist ideas about the redistribution of wealth. While the concept of private property was never really questioned, much of Iran's industry was nationalised after the revolution.

Studies of the early post-revolution period focus on the creation of the Islamic Republic under Khomeini's charismatic leadership (Ehteshami, 1995). They analyse the role of the various political forces allied (sometimes loosely) to Khomeini's leadership and outline the emergence of the key ideological fractures that emerged within the new

political establishment, divisions that remain to this day. While seemingly obvious, we must ask to what degree the Iranian revolution really changed the political system in Iran. Clearly those in high political stations changed and the influence of the clergy was much more pronounced. But, did the revolution change the relationship between the government and society, and thereby between the government and the economy, or was it more a question of changing rhetoric and institutions?

### 3.2 The Novelty of the Revolution

The reality of the Iranian revolution contrasted markedly with the conception of revolution that had prevailed since the late eighteenth century. It rejected historical progress, material improvement, national assertion, historical legitimatisation and democratic sovereignty – five themes which, however violated in practice, were at least invoked formally by modern revolutions from 1789 onward (Halliday, 2003:45). It was in this sense a novel revolution.

...in the proper sense of the word, what happened in Iran was a comprehensively *reactionary* revolution, restoring to the term its original, astronomical, meaning of *return* to a previous order (Halliday, 2003:43).

The revolution in Iran during 1979 shared many of the features of other third world uprisings. It drew support from sections of the civil service and trading communities, and from the poor urban population. The revolution mobilised against a dictatorial regime. This mobilisation was centred around a charismatic leader and an ideology of revolutionary legitimacy.

### **3.2.1 *Brevity of the Revolution and Continuity of Thought***

Unlike many other revolutions that took years to complete in full, the Iranian revolution happened at high speed. Within less than a year and a half, the revolution went from protests to the declaration of the Islamic republic. The timeline of the changes in the structure of the regime suggests that all the contradictions remained to be worked out after the revolution. In fact, many can still be traced to the present. Briefly:

- January 1978: the street protests begin. They are organised by religious students in Qom who are protesting at an anti-Khomeini newspaper article.
- Strikes and protests in Iranian cities occur over the next few months. They are organised by the clergy and supported by the bazaars.
- September 1978: the religious processions after Ramadan become large political protests.
- 8 September 1978: martial law is imposed and shooting of demonstrators by the government follows.
- October 1978: the wave of strikes begin. The strikes become a nationwide political general strike. The general strike begins in late November 1978. Importantly, the oil fields, which are at the heart of the Iranian economy, are shut down.
- 5 November 1978: the Shah is under pressure from the military. Eventually he appoints a military government. The military government which he appoints is unable to end the strikes. In December, the government is forced to allow new street demonstrations. This is during the Shi-ite festival of Ashura.
- Throughout this period, Khomeini leads the protests from his exile in Paris.
- 15 January 1979: the Shah leaves Iran. The former opposition leader and secularist, Shahpour Bakhtiar, becomes head of the government.



- 1 February 1979: Khomeini returns to Iran from Paris. He refuses to negotiate with the Bakhtiar government. Khomeini pronounces Mehdi Bazargan head of a rival government.
- 10/11 February 1979: there are pro-Khomeini mutinies by the armed forces. The army declares itself neutral. The Bakhtiar government collapses.
- 30 March 1979: the Islamic Republic is declared after a referendum.
- November 1979: an Islamic constitution is passed by referendum. Khomeini is officially accepted 'supreme leader', not only *faqih* but *valy-e faqih*.
- January 1980: Abol-Hasan Bani-Sadr is elected President. Following its election the *Majlis* (which is dominated by the Islamic Republican Party) selects Mohammad Ali Rajai as the Prime Minister.

The brevity of the revolution indicates that Iranian society did not have much time to evolve between the secular, arbitrary rule of the Shah and the new Islamic rule. This meant that many of the same factors determining politics and economics in Iran continued into the post-revolution period (Personal Communication).<sup>38</sup> These continuities included the same factors discussed in the previous chapter, including arbitrary rule, the perceptions of the West, and the relations of economic versus political development. However, the combination of these determinants of policy with other specific factors make them appear different. At the same time, religion and revolutionary politics took on increasingly important roles as determinants of policy.

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<sup>38</sup> Personal Communication. Discussions with Dr. Bijan Bidabadi, Faculty Member & Director of Foreign Exchange Research Department of Central Bank of Iran, Tehran, December 2005.

### 3.2.2 The New Political System: Continuity and Change

Ayatollah Khomeini returned to Iran at the start of February 1979, refusing to negotiate with the provisional government headed by the secularist Shahpour Bakhtiar. Khomeini pronounced Mehdi Bazargan, the Liberal Islamist, head of a rival provisional government. Within ten days, following a series of pro-Khomeini mutinies by the armed forces, the Bakhtiar government had collapsed. The end of March saw the Islamic Republic proclaimed following a referendum. A further referendum passed the new Islamic constitution in November 1979, and Khomeini was officially accepted as *valy-e faqih*. In January 1980, Abol-Hasan Bani-Sadr – an Islamic socialist – was elected President, and the first *Majlis* (dominated by Khomeini's Islamic Republican Party) selected Mohammad Ali Rajai as Prime Minister (Halliday, 2003:48-49).

As mentioned earlier, the main elements of change introduced to the form of government, which aimed to reflect as well upon the relationship between the state and society, referred to the blend between the principle of popular sovereignty and that of theocratic rule. Thus, the 1979 constitution was an amalgam of the 1906 Iranian constitution and the French Fifth Republic, with further amendments to incorporate Khomeini's interpretation of Islamic government.

However, these precise changes created contradictions and ambiguities. As a number of commentators have noted, the constitution represented an uneasy compromise between secularist notions, such as the separation of powers and Islamic principles.<sup>39</sup> For instance, the constitution created a (relatively democratic) parliament with roles for a Prime Minister and President. However, these democratic and essentially secular features were counteracted by the creation of the Council of Guardians – a twelve-member body composed of clerics and Islamic jurists with veto power over the *Majlis*

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<sup>39</sup> Abrahamian (1991) notes that the constitution contains significant populist elements, yet also undertakes to safeguard private property; while Owen (2000) draws attention to the disjoint between its secular and Islamic features.

(Owen, 2000:95). This power of veto would provide the key point of conflict between radicals and conservatives within the Fundamentalist Islamist grouping once its grip on power was cemented in 1981. The other essentially non-democratic feature of Iran's 1979 Islamic constitution was the creation of the post of *faqih* in line with Khomeini's notion of *velayat-e faqih* – a post which Khomeini himself held until his death in 1989.

The post-1979 political system can be characterised as “limited popular sovereignty” (Milani, 1997:82), in that it had significant democratic elements (particularly in relation to the regional and historical norm), but this nascent popular sovereignty was “disfigured” by five key constitutional features (Milani, 1997:82):

- the constitution put God, not the people, as the ultimate authority;
- it provided a hierarchy of power with God at the top, the people at the bottom, and (crucially) the clerical establishment in the middle;
- it granted unelected bodies (the Council of Guardians and *faqih*) powers of veto and appointment over democratically-elected politicians;
- it limited the power of the President (the only nationally elected figure) by granting the *faqih* powers to sack him and to command the armed forces; and finally
- the constitution curtailed freedoms (of the press and of assembly) if deemed inimical to Islam.

This ‘limited popular sovereignty’ is in line with traditional Shia ideology in that it states that only the highest clergy can deduce the Qur'an's secret meaning (*batan*) from its apparent meaning (*zاهر*).<sup>40</sup>

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<sup>40</sup> This emphasis on clerical interpretation is also present in the Shia subsystems associated with Shariati, Motahari and Navab-Safavi (as discussed in Shahriari-Rad, 2002).



The above blend generated not only a specific ideological makeup in Iran, but also favoured increased factionalism within the government and created political deadlocks between the radicals and the conservatives. The creation of parallel institutions signalled that the structural features of the previous (i.e. repression of dissonant voices) regime still persisted, despite the difference in the political institutions. However, unlike the pre-revolution period, now the Islamic and populist/socialist rhetoric was deeply felt and impacted upon the Iranian economic decision-making process (Personal Communication).<sup>41</sup>

### *3.2.2.1 Ideological Makeup*

The ideological makeup of Iran reflects the mixed tendencies to create a state based on popular sovereignty and theocratic institutions. Shi'ism, due to its ideological variety, allowed for this blend to be further emphasised in the political ideology of various groups. Thus, the post-revolution clerical establishment (including Khomeini himself) should be understood as borrowing elements from the various ideological 'subsystems' within Shi'ism in order to enhance its position of power, rather than individually and consistently subscribing to any particular subsystem. Furthermore,

Failure to grasp the flexibility which the adoption of different aspects of various subsystems offers to the clerical leadership leads to erroneous categorisations such as Islamic modernists, traditionalists, fundamentalists, moderates, extremists, etc. (Milani, 1997:82).

Thus, the clerical leadership can be seen as having a range of tools to draw on. In particular, there were four distinct ideological strands within Iranian Shi'ism that have

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<sup>41</sup> Personal Communication. Discussion with Dr. Manouchelir Lighrani, M.D., former landowner, Tehran, December 2004.

informed the establishment's governing programme since 1979. The first strand, linked to Ayatollah Morteza Motahhari, is an essentially conservative interpretation of Shi'ism that rejects the Marxist elements incorporated into Islam by the *Maktabis*. Motahhari was a leading cleric, a member of the influential Revolutionary Council and a close confidante of Khomeini (Rahnema and Nomani, 1990:39-40).<sup>42</sup> His key motivation was to counter the anti-clerical currents common among young Islamic revolutionaries; he also had a "deep respect for the market system based on private property... [which] removed the anxieties of property-owning classes" (Rahnema and Nomani, 1990:42). This defence of private property placed him in the *Hojatieh* tradition, although his emphasis on the political role of the clergy - embodied in Khomeini's notion of *velayat-e faqih* - was not universally popular with conservatives (Ehteshami, 1995:9).

Rahnema and Nomani outline a second strand of Iranian Shi'ism at the time, which they link with the work of the intellectual Ali Shariati, a nationalist supporter of Mossadeq in the 1950s. Shariati's Shi'ism borrowed extensively from the Marxism-Leninism promulgated by the pro-Moscow Tudeh party. The authors go as far as to argue that "Shariati's achievement was the utilisation of Islam as a socially applicable... form of presenting a content which could be considered as essentially Leninist" (Rahnema and Nomani, 1990:53). Hence, Shariati emphasised the division between the oppressors and the oppressed. This was an essential part of Khomeini's own pre-revolution rhetoric (Abrahamian, 1991). However, Shariati differed from Khomeini in arguing for an Islamic state without clerical leadership (Rahnema and Nomani, 1990:62).

The Islamic Republic's leadership arguably borrowed from Shariati's rhetoric, particularly in building support for the revolution during the final years of the Shah. Shariati's belief in a "totalitarian transitional government" – derived from an "elitist and paternalistic position in relation to the people" – can also be interpreted as "very similar

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<sup>42</sup> He was assassinated in May 1979 during the bloody early months of the Islamic Republic.

to Khomeini's concept of an Islamic government" (Rahnema and Nomani, 1990:67). However, Khomeini was also careful to uphold property rights in order to avoid alienating his conservative business constituency (Ibid.:61).

A third, essentially conservative reading of Shi'ism is embodied in the career of Sayyed Mujtaba Mir-lowhi (known as Navab-Safavi), the founder of the radical Islamic group Fadaian-e Islam that violently opposed the Shah. As the authors argue:

Navab-Safavi's subsystem represents a violent and reactionary Islam which contains many of the necessary attributes of a totalitarian system (Rahnema and Nomani, 1990:78).

This reactionary reading of Islam – a demand for the strict implementation of the *shari'a* under a theocratic government – proved popular amongst the huge numbers of rural migrants to Tehran and other cities, the groups most alienated by the rapid cultural and economic change instigated by the Shah's development policies. Migrant workers reacted to this "alien cultural environment" by forming *hey'ats* (informal religious groups), which went on to form important powerbases for the Islamic Republic's rising political stars (Ibid.:90). This "vast source of bigoted militancy" would become the "vengeful executive arm of the clergy" (Ibid.:88) – the *komites* (vigilante police) and *Pasdaran* (revolutionary guards) who participated so effectively in the post-revolution terror (Milani, 1997:84).

Finally, there is a more liberal reading of Islam, associated with veteran nationalist (and first Prime Minister under the Islamic Republic) Mehdi Bazargan. Bazargan tried to blend Islam and liberal democracy. Essentially, he argued for a constitutional theocracy in which religious observance was a matter of individual conscience and the clergy has little or no political role (Rahnema and Nomani, 1990:99-116). Although Khomeini had links with Bazargan – as testified to by the latter's appointment as Prime Minister in

February 1979 (Halliday, 2003:48-49) – little of Bazargan’s liberalism found its way into the Islamic Republic’s political direction after the more conservative clerical establishment cemented its grip on power in subsequent years. However, elements of Bazargan’s more liberal reading of Shi’ism can arguably be identified in the philosophy of President Mohammed Khatami, and the views of his brother and key advisor, Reza Khatami.

Against this background, therefore, it becomes all the more important to rethink the concept of development, to imagine development in the context of the particular society and its culture, its religious aspirations and values, and its rapidly changing social fabric.

### 3.2.2.2 *Parallel Institutions*

The specificity of the institutions created by the revolutionary regime does not necessarily imply a break with the practices of the previous regime. On the contrary, the emergence of parallel institutions under the leadership of Khomeini and the Islamic Republican Party (dubbed Khomeini’s ‘mini-state’) (Milani, 1997) was motivated by the same drive to consolidate and preserve power. Repression was the means to achieve it.

Khomeini’s ‘mini-state’ drew much of its support from the culturally alienated rural-urban migrants (the “vast source of bigoted militancy” [Rahnema and Nomani, 1990:88]) and was funded by Khomeini via the Mostazefan (Oppressed) Foundation, which had expropriated the assets of the royal family and their associates. The ‘mini-state’ adopted a range of unofficial organisations, including the *Komites*, the *Pasdaran*

and the Revolutionary Courts, who dispensed brutal summary justice to those deemed opposed to the pro-Khomeini forces (Milani, 1997:84-85).

Khomeini's 'mini-state' had effectively neutered all opposition by 1983, moving against the secularists and Islamic Liberals associated with Mehdi Bazargan's interim government, and then forcefully ejecting the Islamic Socialist Bani-Sadr (whom Khomeini had chosen as the Islamic Republic's first President) from office in 1981. Even senior clerics were not immune. Ayatollah Seeyed Kazem Shariatmadari, who had opposed the *velayat-e faqih* provision of the constitution, was "virtually put under house arrest until his death in 1986" (Milani, 1997:85).

After the dismissal of Bani-Sadr in 1981, the clergy's control over the Islamic Republican Party, and therefore the government, was almost total (Rahnema and Nomani, 1990:255). This ushered in a period of "pragmatic clerical rule", with forces close to the spiritual leader forcing the more militant members of the clerical coalition to tone down their revolutionary rhetoric and bring an end to the "semi-anarchy" of the "mini-state's parallel institutions" (Ibid.:256).

### 3.2.2.3 *Factionalism and its Consequences for Political and Economic Policies*

Factionalism did not simply act as a determinant of policy-making in Iran. It was related to Khomeini's own ambiguous political views, which drew on different trends within Shi'ism. The swing between popular sovereignty and theocratic rule represented an additional factor (Milani, 1997).

During the revolution period (1977-79) and in the early years of the Islamic Republic, political participation was at its peak (Ibid.:77). The revolutionary movement itself was initially extremely wide-ranging, with factionalism temporarily in abeyance. As



Katouzian argues, the Islamic Revolution (in common with the 1905–09 Constitutional Revolution) had “the support of the entire political society” (Katouzian, 2003:31). Milani characterises the 1977–79 period as “the golden age of Iran’s mass politics” (Milani, 1997:83). However, he goes on to catalogue how Khomeini created a political ‘mini-state’ within the broad coalition of anti-Shah forces, which then went on to destroy its revolutionary comrades one by one.<sup>43</sup> With political participation outside the establishment outlawed, it took “the form of involvement in factional politics” (Milani, 1997:85).<sup>44</sup>

Factionalism within the Islamic Republican Party resulted in part from the dominant role in government of Khomeini himself – as *faqih*. As Milani (1997) observes, Khomeini kept the party’s various factions competing with each other in order to maintain his own position at the top of the republic’s power structure. Khomeini eventually tired of the infighting, which had resulted in a damaging legislative gridlock, and disbanded the Islamic Republican Party.

However, the end of the party did not bring an end to factionalism, which continued to hamper the implementation of the radical legislative agenda of the left-leaning faction that considered itself closest to Khomeini. To this extent, factionalism under Khomeini reflected the fact that, despite being the Islamic Republic’s figurehead and most gifted political operator, he was unable to maintain total control over the regime (Owen, 2000:181). In particular, he remained constrained by powerful conservative elements

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<sup>43</sup> Unlike Milani, Owen argues that the elimination of opposition forces and alternative centres of power was undertaken by the Islamic Republican Party leadership rather than by Khomeini directly, as “the role of the Ayatollah Khomeini in [the process of the Islamic Republican Party’s post-revolution ‘takeover’] ... was not at all clear cut” (Owen, 2000:180).

<sup>44</sup> Milani argues that factionalism was a new development under the Islamic Republic. However, the Shah’s attempts at creating civil society institutions in the second half of the 1970s, discussed in the previous section, constitute the first flowerings of factionalism. Milani is undoubtedly right, though, to contend that: “...it is because of factionalism that some primitive kind of pluralism among the governing elites is developing in Islamic Iran. ...The supporters of the Islamic Republic enjoy more freedom to debate important issues than the shah’s supporters had under the monarchy” (Milani, 1997:86).

within the clerical establishment who were opposed to the more radical 'Islamic Socialist' proposals that initially attracted so many Iranians to the Islamic Republic's banner (Milani, 1997:87).<sup>45</sup>

There was also a deeper issue that contributed to the factionalism, which has been analysed under the ideological makeup of the political system, which was Shi'ism. One can assert that it has not only provided a variety of tendencies within Iranian society with respect to different issues (the role of the state, propriety, etc.) but also determined or envisioned the type and possibilities of political action, depending on the vision supported by Khomeini. It nurtured, in other words, a variety of potential policies on private property, for example, but also accounted for the failure of the system to function by nurturing factionalism and political deadlocks. Shi'ism has traditionally been a "polycephalic faith" (Milani, 1997:86). Shi'ism, unlike some other religions, and to a degree unlike Sunniism, has neither a church nor accepted power hierarchy. The Islamic constitution of Iran originally stipulated that the *faqih* must be a marjaetaqlid, as well as be accepted by the majority of the people. This was an attempt to create a hierarchy of religious as well as political powers – i.e. something which had never existed before. But even under Khomeini, other grand ayatollahs (Seyyed Kazem Shariatmadari and Mohammad Reza Golpayegani) had large mass followings. While there is not the space nor need to cover the revision of the constitution in 1989, it also played a role. The revision meant that the *faqih* was no longer required to be a marjaetaqlid, nor accepted by the majority of the people.

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<sup>45</sup> The conservatives also tended to be less inclined towards Khomeini's thesis of '*velayat-e faqih*', or Jurist's guardianship, his conception of Islamic government that placed the clergy at the centre of power and allowed them to interpret Islamic law indirectly rather than impose *sharia* directly (Wells, 1999). As Roy argues, "Khomeini always imposed revolutionary logic, represented in the guide's will, if need be over the *shari*" (Roy, 1994:176). Conservatives, by contrast, tended to favour direct implementation of *sharia* rather than the essentially secular legal framework, combined with *velayat-e faqih*, created by the framers of the 1979 constitution. This conception of Islamic governance was actually the mainstream view amongst the upper echelons of the clergy, even in the early 1980s (Ibid.:173). The succession of Khomeini, a relatively junior cleric and hardly the senior jurist demanded by the logic of Khomeini's philosophy, to the *faqih*-ship significantly undermined the system's authority.

Hence, in 1989, the Assembly of Experts were able to select Seeyed Ali Khamenei as the new *faqih*, even though hojatolislam was ranked below ayatollah. At the same time, Khamenei had declared that he was not seeking religious leadership in Iran. Milani notes that:

...this fact is testimony to the Islamic Republic's failure to render Shi'ism monolithic, as there are many people who follow not Khamenei but other ayatollahs in Iran and Iraq. Therefore, factions and Shiism are inseparable, like two sides of the same coin (Milani, 1997:86).

Grounded in the "diversity of [the Islamic Revolutionaries'] socio-economic interpretations and subsequently programmes" (Rahnema and Nomani, 1990:37), chronic factionalisation characterised the first decade of the Islamic Republic. During the immediate post-revolution period, three distinct factions of 'republican contenders' emerged and competed intensely for power. Of these groups, the Fundamentalist Islamic Republicans and Liberal Islamic Republicans quickly neutralised the Secular Republicans. By 1981, the Fundamentalist Islamic Republicans had also successfully eclipsed the Liberal Islamic Republicans (Ehteshami, 1995:8).

The Fundamentalist Islamic Republican group itself consisted of several competing factions, ranging from the '*Maktabis*' (radicals who combined elements of Marxism with traditional Shi'ism) to conservatives centred on the *Hojatieh* society (more traditionalist clerics allied to business interests). Between these competing extremes were more pragmatic, career-oriented politicians, many of whom rose to prominence following Khomeini's death in 1989 (Personal Communication).<sup>46</sup>

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<sup>46</sup> Personal Communication. Discussions with Dr. Bijan Bidabadi, Faculty Member & Director of Foreign Exchange Research Department of Central Bank of Iran, Tehran, December 2005.

The explosion of factionalism within the ruling coalition made policy implantation (particularly with regard to economic policy) virtually impossible.<sup>47</sup> As discussed above, the critical stalemate was over the issue of private property, where radical groups within the *Majlis* saw their attempts to introduce anti-capitalist policies consistently blocked by the conservatives in the Council of Guardians. The policy log-jam period was characterised by:

...the arena of public property that the strict interpretation of Islam, in defence of the propertied class and in support of the conservative political forces, gains the upper hand over any reading of Islam in support of the populist political forces. This confrontation is seen in the experience of the Islamic Republic of Iran, where from the summer of 1980, when the Majles was established, to the end of the third Majles in the summer of 1992, all the main reform laws passed by the populist parliament, such as land redistribution, nationalisation of foreign trade, and the labour law, were rejected by the Council of Guardians as being incompatible with Islamic precepts (Rahnema and Behdad, 1995:12-13).

The 1987 labour law was “the point of greatest intensity in the economic dispute between the two factions” within the clerical establishment (Rahnema and Nonani, 1990:267). The Council of Guardians rejected half of the proposed law’s 200 articles as un-Islamic. The Council continued to obstruct the law’s implementation even following interventions by Khomeini in its support. The divisions over land reform were intense, and “such was the strength of conservative feeling that a bill proposing only a moderate

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<sup>47</sup> However, some analysts put it more strongly. Rahnema and Nonani note that: “Infighting has been endemic to the Islamic Republic in the process of its formation and establishment and it has its roots in the different politico-economic interests of the clergy and the realities of a crisis-ridden Iranian society. *Ad hoc* decision-making and reaction to short-run economic events, political conflicts, rhetoric and phrasemongering, confusion and uncertainty and the existence of semi-anarchic decision-making centres prevented the implementation of a stable and consistent programme of economic reform between 1979 and 1989. Measures that have been implemented have not been sufficient or efficient enough to check the disastrous economic downturn which has characterised this period. In 1984, a clerical member of the second Islamic parliament summarised the fate of the economic institutions and policies of the Islamic Republic: ‘Islam has a definite economic system [but] since it has not been fully compiled, everyone pulls it in a different direction according to taste.’ This situation has resulted in a severe and protracted economic crisis and a lower standard of living for the Iranian people” (Rahnema and Nonani, 1990:269).

act of rural redistribution... was held up as un-Islamic by the Council of Guardians from 1980 onwards" (Owen, 2000:95). The cause of this institutional gridlock was the sharp division between two competing interpretations of Islam in the area of property rights, and the existence of competing power-bases controlled by these different ideological factions embodied in the Islamic Republic's 1979 constitution.

Thus, the implementation of a stable, consistent programme of economic reform under Khomeini was prevented by political conflicts "and the existence of semi-anarchic decision-making centres" (Rahnema and Nomani, 1990:269).

### **3.3 Features of the Iranian State: What Changed in the State–Society Disjunction**

As noted in the previous chapter, 'arbitrary rule' characterised Iran's inability to forge a stable political system (Katouzian, 2000; 2003). In other words, arbitrary rule signifies a disjunction between the state and society in that state; rather than representing the interests of one particular class or group, it exercises arbitrary power over all groups in that society, outside the confines of an established set of laws (Katouzian, 2003). The use of violence and discretionary measures are necessary mechanisms for arbitrary rule. Clientelism is a direct consequence of such a state, as it allows benefits to only a small group of followers in exchange for their support of the regime. It also conditions the business relations with other actors, since the state is not an equal partner but one who has the power to impose and change the rules of the game while still playing.

An interesting element of the post-revolution period, on the other hand, is the attempt to combine principles of popular sovereignty with the ones related to clerical rule. It will be shown that the constitution of the Islamic Republic had, at its core, a contradiction between popular sovereignty and the role of the clerics. The state's theocratic

foundations were laid and embodied in the concepts of *velayat-e faqih* and the institutions of the *faqih* and the Council of Guardians (Rahnema and Behdad, 1995:11). Thus, although the Islamic Republic provided for limited popular sovereignty – an opportunity to change the extant relationship between the state and society – Iran’s constitution prioritised the power of the clerics over that of democratic institutions, stating that the framers of the 1979 document “created a system that is more Islamic than republican” (Milani, 1997:82).<sup>48</sup>

The existing constitutional arrangement, although no longer representing an arbitrary state, at least shares some notable features with one. Firstly, although power is no longer exercised indiscriminately, the power of the clerical establishment to override popular sovereignty – and the repeated exercising of this power – is indicative of a state with arbitrary features. Secondly, although the clerical establishment is not wholly removed from wider society, significant factions within it command support from various parts of society, and its exercising of *almost* arbitrary power has the potential to alienate large swathes of the population in the manner of previous Iranian rulers.

Despite the persistence of the above-mentioned features within the Iranian state, one may also say that the revolution did make some fundamental changes in the relationship between society and government. The next question to ask is what were the new factors which affected the government’s decision-making process?

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<sup>48</sup> Milani also cites Ayatollah Mohammad Hosseini Beheshti, the writer of the *velayat-e faqih* provision of the constitution, who argued that once the Iranian people had freely embraced Islam in the April 1979 referendum on the creation of the Islamic Republic, then the limits of popular sovereignty must be dictated by the boundaries of Islam, interpreted by the clergy (Milani, 1997:83).

### 3.3.1 *Post-revolution Government*

The post-revolution government needs to be understood along two lines. Firstly, there was a fundamental tension between the secular nature of the post-revolution government institution and its religious basis. Secondly, the revolution changed the political landscape and brought out new constituents which influenced policy. By analysing the politics of Iran with these considerations, it is possible to discern the effect that politics had on the evolution of oil policies. In particular, how Islam, or rather the Iranian take on Islam, affected oil nationalisation, how the various constituencies within the Iranian government created the post-revolution economic system, and how they contributed to its change over time.

In post-revolution Iran there was a tension between politics and religion which must be explored. This tension was partially attributable to the ambiguity of Khomeini's political views, and may be expressed as being between a fundamentalist form of rule and a populist one. While Khomeini was not able to overcome this tension, he did appreciate it (Personal Communication).<sup>49</sup>

### 3.3.2 *The Role of the Leader: Khomeini's Political Views: Populism, Shi'ism and Popular Sovereignty*

The role of the leaders in decision-making processes (either with respect to foreign policy or the domestic one) has been long emphasised in the literature on foreign policy analysis (Jervis *et al.*, 1985; Anon, 1997). This is especially so in more 'traditional states' where authority is centralised, the political system is not very diversified and

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<sup>49</sup> Personal Communication. Discussions with Dr. Bijan Bidabadi, Faculty Member & Director of Foreign Exchange Research Department of Central Bank of Iran, Tehran, December 2005.

allegiances are based on belonging to the same community of belief; strong and charismatic leaders are pivotal in understanding the overall interactions at the political and economic levels.

Ayatollah Khomeini was such a leader. It should be noted that this man was nominally in a position of leadership (as *faqih* and as the revolution's undisputed figurehead) to unite the political factions, his own philosophical position was difficult to interpret, and his loyalty seemed to switch from one faction to another over time. This reflected into a rather unstable political life, since the criteria for 'legitimate' rule changed on the humours/whim of one man.

Unlike the Shah, Khomeini appears to have appreciated the tension between economic development on the one hand and cultural and equity questions on the other (Personal Communication).<sup>50</sup> However, for all his formidable political skills and initial mass appeal, he failed to find the means to overcome the tension between the worlds of the material, the political, and the cultural or spiritual.

Khomeini certainly succeeded in giving a political voice to the cultural and political tensions raised by the Shah's development policies. As a noted cleric and long-standing opponent of the Shah's policies, Khomeini personified the cultural opposition to the Shah's programme of economic development. Zonis (1983:591) notes that "Khomeini was widely believed to embody many of the central values of Iranian culture, values that the Shah was seen as having desecrated".

He was also, perhaps uniquely, able to create a unified political message that brought together a traditional Islamist critique of Western-style capitalism with a radical rhetoric

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<sup>50</sup> Personal Communication. Discussion with Dr. Manouchelir Lighrani, M.D., former landowner, Tehran, December 2004.



that was, if not Marxist, then certainly populist. “We should recognise Khomeinism as a specifically religious variant of populism” (Abrahamian, 1991:106).

This mix can be seen to have produced a tension between fundamentalism and populism. Fundamentalism, which comes from a description of early twentieth-century American Protestantism, refers to a conservative orthodoxy concerning religious issues.

Populism refers to:

...predominately middle-classed [political] movement[s] that mobilise the lower classes, especially the urban poor, with radical rhetoric against imperialism, foreign capitalism and the political establishment (Ibid.).

In particular, populism was used as a political ideology in Latin America. One can argue that although Iran is generally seen as a fundamentalist state, Khomeini’s political views better fit the description of a populist rather than fundamentalist approach (Ibid.).

The ambiguities of Khomeini’s discourse can be explained both through emphasis of the role of instrumental rhetoric and through a more fundamental issue, which is religion, and more specifically Shi’ism.

Unlike Sunniism, Shi’ism does not present a consistent theory of the state (Ibid.). The Sunnis have traditionally associated religious duty with obedience to the state. Shi’ism, on the other hand, has been divided. Some believe that the existing states should be seen as usurpers (of the Hidden Imam) and therefore authorities should be shunned, while others believe in a range somewhere between grudging acceptance that a state is better than no state to a complete acceptance of legitimacy of the state similar to the Sunni view.

Opinion appears divided as to Khomeini's views (Personal Communication).<sup>51</sup> His sympathies may have lain more with the radical, Maktabi, tendency of the revolution. There was correspondence between Khomeini and Khamenei in 1988 over the role of the state. Khamenei, widely viewed as a conservative champion among the clergy, had argued for a limitation in the state's role on Islamic grounds. Khomeini overruled him, countering that the Islamic Republic's government was "a supreme vice-regency bestowed by God" which could interpret Islam and take precedence over "all peripheral divine orders" (Halliday, 2003:69).

Khomeini's earlier writings reflected these oscillations and vagueness. But, by the 1960s, his views turned towards an anti-monarchist perspective. He began to argue that only the *ulama* and *fuqaha* (religious jurists specialising in Shari'a law) had the legitimate right to rule. This shift naturally led to the possibility of populist opinions by making revolution an acceptable option.

In parallel, his views on society began to change. Initially he believed in the more traditional notions of society, which agreed with private property and a God-given hierarchy within society that should be respected, though not flaunted. After the 1970s he took a more egalitarian view, distinguishing the oppressors (rich) from the oppressed (poor) (Abrahamian, 1991). His new social views were then applied to the Shah, who he accused of widening this divide. These accusations relied on populist rhetoric and can be seen as the switch between a more traditional, conservative approach and one which more or less explicitly relied on populism.

During the 1978-79 build-up to the revolution, the political slogans of Khomeini and his allies increasingly resembled a rhetoric more closely associated with leftist politics: attacking the increase in inequality under the Shah, calling for an end to oppression and

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<sup>51</sup> Personal Communication. Discussions with Dr. Bijan Bidabadi, Faculty Member & Director of Foreign Exchange Research Department of Central Bank of Iran, Tehran, December 2005.

class differences, and broadening the message of the revolution to embrace not only Muslims, but the “oppressed nations of the world” generally (Abrahamian, 1991:112-115).

However, as Abrahamian notes, once in office Khomeini was unable, or unwilling, to implement the kind of radical economic reform that initially attracted so many leftists (Islamic and secular) to his cause. This could have been predicted as, even at its height, Khomeini’s populist rhetoric was “extremely vague on specifics and silent on the question of private property” (Ibid.113). Or when Khomeini’s pronouncements on private property were uttered, they were far from coherent. The same Khomeini who stated that “Islam will eliminate class differences” and “we are for Islam, not for capitalism” (Ibid.:114) also argued that “as long as there is Islam there will be free enterprise” (Ehteshami, 1995:8). At the same time, in the views of at least one analyst, Khomeini’s overall goal was “to invert Islamic authority so as to free the actions of the state from any Islamic restrictions, particularly with regard to property” (Halliday, 2003:70). Abrahamian goes on to note that:

Despite the radical rhetoric, the [Islamic Republic’s] Constitution undertook to safeguard private property. ...What is more, it intentionally avoided the socialistic phrase *nezam-e towhidi* (unitary order), a term which the Mojahedin and other Islamic radicals – as opposed to populists – wanted enshrined into the republic’s Constitution (Abrahamian, 1991:117).

Also:

Khomeinism – like Latin American populism – is mainly a middle-class movement that mobilises the masses with radical-sounding rhetoric against the external powers and entrenched classes. But in attacking the establishment, it is careful to respect private property and avoid concrete proposals that would undermine the petty bourgeoisie (Abrahamian, 1991:118).

These contradictory views on the role of the state and private property may be explained through Khomeini's mix of Latin American populist, traditional Islamic and socialist ideas. However, Khomeini drew on these different discourses instrumentally. One can safely say that Khomeini's principle aim can be interpreted as gaining and maintaining political power for the clergy. Therefore, the leftist rhetoric in the run up to the revolution was intended to garner support from the Left. "Religious fundamentalism would never have won such support" (Abrahamian, 1991:118).

Similarly, Khomeini's oscillations in power can be seen as an attempt (largely successful) to manage his broad clerical coalition. For instance, creation of the Islamic Republican Party by Khomeini's clerical allies provided a forum for dissenting opinions within the clerical establishment, and the development of competing wings also allowed Khomeini to practise divide and rule. This necessitated alternating support for the different wings to prevent any single branch of the party becoming dominant (Milani, 1997:86-87).<sup>52</sup>

In government, conservative elements in Iran's clerical establishment, centred around the secretive *Hojatieh* society, used their control of the Council of Guardians to block attempts by the Khomeini-inspired Islamic radicals in the *Majlis* to institute populist economic measures.<sup>53</sup>

A bill proposing only a moderate act of rural redistribution involving uncultivated land was held up as un-Islamic by the Council of Guardians from 1980 onwards (Owen, 2000:95).

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<sup>52</sup> Khomeini eventually tired of the party's squabbling and dissolved it in 1987.

<sup>53</sup> Ehteshami details the structure and ideological orientation of the various factions making up Iran's clerical establishment in the post-revolution period (Ehteshami, 1995). The *Hojatieh*, initially formed in the 1950s as an anti-Bahai organisation, was fiercely anti-communist, socially traditional and supportive of free enterprise.

Despite widespread participation of secular leftist and 'liberal Islamic Republican' groups in the early days of the revolution and in Bani-Sadr's provisional government, these groups were ruthlessly suppressed by the dominant conservative groups once the latter had consolidated their control over the Islamic Republic's institutions in the early 1980s (Ehteshami, 1995:10-12). The Tudeh, composed of Moscow-leaning communists, was the last secular leftist party to be banned, in 1983.

The structure of the political system (with the existence of parallel institutions like the revolutionary courts) and the tendency towards factionalism (a continuous feature of the Iranian establishment) required a strong leader to centralise the decision. This conveniently overlapped with Khomeini's tendencies to impose himself as the ruler of the Iranian state. His instrumental oscillation between different factions did, however, feed back into the system, and favoured instability and political log-jam.<sup>54</sup>

Given the separation of powers and existence of so many parallel institutions like the revolutionary courts, cohesion was only possible when implemented by Khomeini himself as the Faqih and leader of the revolution. ...[Unfortunately], in practice, the ayatollah was slow to come down on one side or another in the various factional disputes that ensued (Owen, 2000:95).

The log-jam was marked in practice by events such as the ones described above and opposition on behalf of the Council of Guardians against laws passed by the *Majlis* on grounds of being un-Islamic. Ayatollah Khomeini continued to oscillate in his support of these tendencies until his death in 1989 (Behdad, 2000:104). Furthermore, the endemic factionalism of the Islamic Republic's leadership and the ambiguity of Khomeini's own position meant that the 'First Republic' leadership (1979-89) failed to address the tension between the material, the political and the spiritual.

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<sup>54</sup> See section 5.3 for a discussion of the Islamic Republic's political institutions. Also, information from Personal Communication. Discussions with Dr. Bijan Bidabadi, Faculty Member & Director of Foreign Exchange Research Department of Central Bank of Iran, Tehran, December 2005.

The new regime's popular legitimacy, the necessities of war and the charisma of Khomeini constituted important factors in the persistence of the regime. Unlike the Shah's rule, these factors did not cost the regime its political life. However, it set the scene for further failure by its successors in the 'Second Republic'.

The intention of this section has not only been to identify the ambitious aspirations of the Islamic Republic, but also to illuminate the paradoxes in the political and economic policies, which have stemmed from the limiting factors placed upon its claimed policies by the well-guarded religious beliefs. In the next section, the focus of this study will move on to the contradictions between political, cultural and ideological beliefs on the one hand and Iran's global outlook, on the other.

### **3.4 External Relations**

The complex mix of domestic and foreign policy is evident during Khomeini's rule (Gourevitch, 1978). Iran's position and reputation in the world would be determined by two main events: the 1979-81 hostage crisis and the 1980-88 Iran-Iraq war. These events would cause massive economic and social dislocation within Iran, in addition to wider international hostility (e.g. soured relations with the US for a generation) and economic difficulties resulting from declining oil prices and significant capital flight. This chaotic economic and political context made the adoption of a coherent policy agenda difficult, even for a skilled political operator like Khomeini (Rahnema and Nomani, 1990:269).

The fact that Iran was now a 'revolutionary' country domestically spread the belief amongst Western countries that its 'revolutionary' impetus was aligned to its foreign policy. The revolutionary rhetoric of Khomeini shaped relations with the West and it

reverberates into the present. In other words, the perceptions about Iran as an international actor are to be traced to this particular period. They continue to play an important role in shaping the possible options open to Iran internationally, and also domestically, in terms of policies.<sup>55</sup>

The hostage crisis (Tehran, November 1979) reflected the different domestic trends with respect to foreign relations issues, and how some factions could act irrespective of the other views existing in the same political party. It put into practice Khomeini's repeated calls for attacks on US and Israeli interests. In Katouzian's words:

...had been either intended or was quickly recognised as a potent weapon for promoting the interests of both the ideological (*maktabi*) Islamists and the Marxist-Leninist left ... at the expense of more pluralistic trends within the revolution (Katouzian, 1989:57).

The rift grew with the Iran-Iraq war.<sup>56</sup> Both the war and hostage crisis were linked to the political competition within the clerical establishment over the appropriate foreign policy stance. For many *Maktabis*, the export of the revolution and confrontation with the West were essential parts of the revolutionary programme. "Within the ruling elite, the issue of the war was inextricably linked with the question of the export of the revolution" (Ehteshami, 1995:23). The Iraqi invasion, although unwelcome, provided an opportunity to export the revolution to Iraq, whose majority Shia population, according to Tehran's thinking, might have been open to Iran's revolutionary agenda. This helped to explain Iran's unwillingness to enter into peace negotiations, despite the war's mounting economic and human cost. Khomeini was reluctant to accept the UN Security

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<sup>55</sup> For example, see the policies on nuclear energy, section 5.4.1.

<sup>56</sup> The Iran-Iraq war was precipitated by the Iraqi attack on Iran in September 1980. Iraq was widely perceived to have obtained at least tacit approval for its invasion from the West, and from the US more specifically.

Council Resolution (SCR 598) heralding the end of the war, and eventually only did so following mounting pressure from Rafsanjani and other pragmatists.<sup>57</sup>

Similar thinking motivated the arming of Shia guerrillas in Lebanon and Afghanistan, the steady criticism of the Saudis' pro-Western policies, and Khomeini's final contribution to Iran's foreign policy - the 1989 fatwa calling for the murder of the British author Salman Rushdie.

With respect to the Rushdie affair, the fatwa provided "a means of meeting [Khomeini's] two main policy goals - mobilisation at home, confrontation internationally" (Halliday, 2003:71). Khomeini's rhetoric in the early days of the revolution had been explicitly internationalist.<sup>58</sup> This populist and nationalist message, casting Khomeini as a "Third World revolutionary" (Roy, 1994:179), essentially died with Khomeini in 1989.

The trade and economic sanctions, as well as the freezing of Iranian assets imposed by the US authorities in response to the hostage taking, combined with the additional economic dislocation caused by the Iraqi invasion towards the end of 1980, eventually led to the diffusing of the crisis and release of the US hostages. The entire situation contributed to the modelling of a negative picture with respect to Iran internationally and its diplomatic isolation (Krasner, 1978; 1979).

As will be discussed in the next chapter, the foreign policy area is one where the victory of 'realists' or 'pragmatists' (personified by Rafsanjani) since Khomeini's death is clearest (Ehteshami, 1995:29). It was embodied in the first five-year development plan,

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<sup>57</sup> Khomeini stated that "the acceptance of the resolution... was a bitter and tragic issue for everyone and particularly for me... death and martyrdom would have been more bearable to me" (Ehteshami, 1995:28).

<sup>58</sup> "The problems of the East come from the West - especially from American imperialism... the oppressed nations of the world should unite against their imperialist oppressors" (Abrahamian, 1991:114).



covering 1990-5, which centred on attracting investment through liberal economic reform. The plan's "emphasis was on economic co-operation with the West and others, which in turn depended on correct, if not warm, diplomatic ties" (Ibid.:42).

### **3.5 Economic Evolution**

The stress of having lived through a destabilising and debilitating period during the eight year war with Iraq was wearing on the psyche of the population at large. The rationing of daily requirements was causing unrest amongst the people. Economic policy-making during the 1979-89 period has been widely criticised. The stagflation (high inflation and low or negative growth) of the period were direct results of the authorities' policies, including the

...nationalisation of the entrepreneurial and the banking system, continued uncertainties over property rights and the role of the private sector in the economy, centralised and inward-looking government policies aimed at maintaining a highly over-valued official exchange rate through import compression, foreign exchange restrictions and generally interventionist economic policies with far reaching implications for resource allocation, particularly in the financial and industrial sectors (Pesaran, 2000:66).

Pesaran argues that the result of these policies "had been an economy in a state of acute disequilibrium with highly distorted price signals" (2000:66).

The economy certainly performed badly over the period.<sup>59</sup> Estimates are that real per capita output declined by 4% per year between 1978 and 1988 (Pesaran, 2000:64). Average inflation over the same period was around 18%, resulting in a similar growth in the exchange rate premium (the gap between the currency's official value and its value on the free market). Underpinning the economic deterioration was a collapse in investment.<sup>60</sup>

There were continuities in the economic policies with the Shah's regime, especially with respect to import substitution industrialisation. Thus, while in other developing countries, their planned economies adopted export promotion strategies over import substitution, "in Iran, by contrast, the old regime's import substitution industrialisation policies were retained and intensified into the post-revolutionary period" (Hakimian and Karshenas, 2000:37). One element of novelty refers to:

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<sup>59</sup> Pesaran, an analyst, points to why this was probably so: "These adverse economic conditions (an acute form of 'stagflation') were due largely to the revolutionary upheavals and their aftermath. ...But they were further exacerbated by the regime's foreign policy adventurism with its adverse consequences for Iran's access to international capital markets, extensive nationalisation of the entrepreneurial and the banking system, continued uncertainties over property rights and the role of the private sector in the economy, centralised and inward-looking government policies aimed at maintaining a highly over-valued official exchange rate through import compression, foreign exchange restrictions and generally interventionist economic policies with far reaching implications for resource allocation, particularly in the financial and industrial sectors. The result had been an economy in a state of acute disequilibrium with highly distorted prices signals. It was clear that the economic policies of the previous decade could not be continued, and a new approach to the management of the economy was needed" (Pesaran, 2000:66). Another analyst points to yet more reasons: "The clerical regime used the war to explain all or most of the country's economic problems. In reality, many stemmed from the distorting and destructive policies adopted after the revolution. The complex system of multiple exchange rates, price controls and rationing, import licenses, and various direct and indirect subsidies distorted resource allocation and adversely affected production and productivity. ...Moreover, these economic policies greatly increased opportunities and inducements for bribery and corruption. Rationed goods sold at controlled prices were often 'diverted' by merchants and corrupt officials to the free market, where they were readily available at far higher prices. Similarly, when combined with a foreign exchange allocation at an artificially cheap exchange rate, an import license amounted to 'a license to print money'. These kinds of activities were far more lucrative than investment in industry or other productive sectors" (Kanovsky (1997b).

<sup>60</sup> Private investment by 1988 was less than a quarter of the level in 1977 (Kanovsky, 1997a).The Washington Institute for Near East Policy, p.53), and much of the investment that did occur was driven by cronyism and distorted price signals, and was probably therefore of doubtful economic value.

...the greater involvement of the public sector in industrial production, and the dominance of semi-public organisations in the form of various charitable foundations with strong political ties to the regime (such as the Foundation of the Oppressed and Disabled). ...this ensured the continued subsidization of the old manufacturing sector and the allocation of foreign exchange to old enterprises at highly undervalued official rates at a time of severe foreign exchange shortages (Hakimian and Karshenas, 2000:37).

The 1980-88 Iran-Iraq war, the decline in oil prices over much of the 1980s and the massive capital flight and brain drain following the revolution also played a significant role. The exodus of physical and human capital has been felt particularly strongly. Brain drain was also a major problem as around two million Iranians, mostly highly skilled, left the country during the revolution and its aftermath. This loss is still instantly apparent in present-day Iran (Kanovsky, 1997a:6).

However, policy errors contributed as much to Iran's poor economic performance over the period. Not only were they bad for the state of the economy, but they encouraged already existing tendencies and activities of corruption and speculation. Kanovsky summarises the state of affairs as follows:

The clerical regime used the [Iran-Iraq] war to explain all or most of the country's economic problems. In reality, many stemmed from the distorting and destructive policies adopted after the revolution. The complex system of multiple exchange rates, price controls and rationing, import licenses, and various direct and indirect subsidies distorted resource allocation and adversely affected production and productivity. ... Moreover, these economic policies greatly increased opportunities and inducements for bribery and corruption. Rationed goods sold at controlled prices were often 'diverted' by merchants and corrupt officials to the free market, where they were readily available at far higher prices. Similarly, when combined with a foreign exchange allocation at an artificially cheap exchange rate, an import license amounted to 'a license to print money.' These kinds of activities were far more lucrative than

investment in industry or other productive sectors (Kanovsky, 1997a:13).<sup>61</sup>

The evolution of a consistent development policy was hamstrung by the ideologically-driven political log-jam. Nomani and Rahnema posit that:

...the Islamic government was unable to draft or implement a medium- or long-term economic plan in the period 1979-89. This was mainly due to factional disputes over the orientation of the 'Islamic economy' among the rulers of the Islamic Republic (1994:182).

A five-year development plan was put before parliament in 1982, but implacable conservative opposition within the clerical establishment saw the plan quietly dropped in 1983. In its place, economic policy was driven by short-term and local contingencies and, paradoxically, by institutional inertia which saw many of the Shah's much-criticised development policies maintained, as with the import substitution mentioned above. With large-scale state ownership stymied by conservative opposition:

...the expanded government role... was thus not solely or even primarily through a shift in balance from private to public ownership. It was manifested in direct interventions in the operation of markets – foreign exchange controls, maintenance of a system of multiple exchange rates, control on interest rates and bank credits – as well as direct price controls in a large number of product markets (Hakimian and Karshenas, 2000:34-35).<sup>62</sup>

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<sup>61</sup> Kanovsky's book was published by the Washington Institute for Near East Policy, whose board members included leading 'neo-conservatives' such as Richard Perle and Paul Wolfowitz noted for their hostility towards the Islamic Republic of Iran. However, notwithstanding this potential source of bias, Kanovsky's criticisms of Iran's economic policies over the period are in keeping with those of others.

<sup>62</sup> Hakimian and Karshenas (2000) provide evidence of the price distortions introduced by these policies: the black market exchange rate premium reached more than 2000% by the end of the 1980s, whilst the prices of energy, bread and other key products had fallen to well below 10% of comparable prices on the international market.

### 3.5.1 *Economics and Islam*

As previously mentioned, the issue of private property became an area of particular contention for Iran's clerical leadership. Opinion differed significantly, reflecting the broad coalition of revolutionary forces assembled by Khomeini prior to 1979 and the competing Shia subsystems which provided for widely differing interpretations of Islamic law on the issue. There is no conclusive guidance for Islam and economic systems and "since it has not been fully compiled, everyone pulls in a different direction according to taste" (Rahnema and Nomani, 1990:269).

This doctrinal vagueness has been widely identified as a core weakness in attempts to orchestrate Islamic government generally.

While Islam promises social justice to the poor and destitute, it also makes it clear that the quest for worldly possessions, the accumulation of property and profit, is not only accepted but highly respected. ...The Islamic revivalist movements promise the establishment of a social order that will unite conflicting aims: the welfare of the poor and the security of property (Rahnema and Behdad, 1995:12).

In fact there is a much deeper contradiction between popular sovereignty and Islamic government in general. For example:

...many Islamic precepts, such as those dealing with the position of women in family and public life, the limitation of the rights of non-Muslims, and certain aspects of social life – for example, Islamic forms of punishments (*hodud-shar'ia*) – are explicitly addressed in the Qu'ran or by Mohammad's Tradition, and are therefore irrefutable. On these and similar matters, there is little room for variation in interpretation (Rahnema and Behdad, 1995:11).

Thus, the Islamic system might prove difficult to change on issues such as the one concerning this study (i.e. privatisation), despite the fact that it might be in the interest

of the population to pursue such an economic policy or that parts of society support the policy. Interpretations having the Qu'ran as a basis might produce several conflicting views. Laws that are regarded as necessary by the parliament (despite its populist outlook) – such as land redistribution, nationalisation of foreign trade, the labour law – can be rejected on grounds of incompatibility with the Islamic precepts by the Council of Guardians (Rahnema and Behdad, 1995:12-13).

The failure to achieve a political compromise on the issue reflected the fact that it was literally impossible. As detailed above, the factionalisation, irreconcilable aims of the conservative and radical wings of the clerical establishment, and vagueness of Khomeini's guidance led to a situation in which all promised objectives could not be simultaneously fulfilled. This inability to develop a coherent economic programme may be described as “the greatest failing of Islamist movements in general” (Halliday, 2003:67).

### **3.5.2 *Nationalisation***

An issue intrinsically related to the discussion on property and to the issue of concern for this thesis is the balance of national versus private ownership in the economy. While the concept of private ownership was not seriously questioned, much of the Iranian economy was nationalised after the revolution (Personal Communication).<sup>63</sup> This issue is, to some extent, an extension of the confusion over the nature of an Islamic economy, as illustrated above. Islamic principles recognise private property, but there are certain limits on it. In particular, there is a need for some redistribution of wealth. The political incantation of this debate was represented by the *Hojatieh* faction, which leaned towards lower taxes and a more free-market approach and the *Maktabis*, who leaned

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<sup>63</sup> Personal Communication. Discussion with Dr. Manouchelir Lighrani, M.D., former landowner, Tehran, December 2004.

towards a centralised planning economic approach. This debate should be seen within the context of the previously discussed phenomenon of political factionalisation. However, one should be cognisant of the fact that there are many groups within these two groups which we have cited here, that are adherents of the mercantile types but do not concur with many of the Hojatiyeh doctrinaire. Similarly, not all Maktabis are followers of a centralised planning approach to the economy.

Before looking at nationalisation in general, it should also be noted that there was more at stake than just a shift from private to public ownership. The revolution was:

...manifested in direct interventions in the operation of markets – foreign exchange controls, maintenance of a system of multiple exchange rates, control on interest rates and bank credits – as well as direct price controls in a large number of product markets. Over time, substantial and entrenched price distortions developed in the economy, with serious consequences at all levels of economic activity from investment to production, trade, distribution, and consumption (Hakimian and Karshenas, 2000:34).

The constitution of 1979 divided the economy into three sectors: state, co-operative and private. To be included in the state sector were 'strategic' industries, such as mining and railways, as well as foreign trade. In particular, as it had been under the Shah, the state had full control over oil revenues. The private sector would be secondary to the state economy and included industry that complemented the state economy, as well as agriculture related business.

Formally, the areas of nationalisation included those properties owned by the court, of owners who had fled the country, and those of firms which owed more than half of their assets to banks (Ibid.). The nationalised industries included those controlled by the court elite, including Iran's 51 major industrialists. This led to the state's control of over 80-85% of the country's industry (Ehteshami, 1995). The court's holding company was

transferred to a new foundation, the Foundation of the Deprived. Later, more Islamic foundations formed to act as additional holding companies. The banking, insurance and mining sectors were also fully nationalised.

Where expropriation of private assets did occur, it generally happened on an *ad-hoc* basis, in response to local imperatives and conditions. Many of the industrial concerns nationalised by the Islamic Republic were heavily in debt to state banks, so that “their nationalisation was largely a method of cancelling their debts to the state” (Katouzian, 1989:56). Others were expropriated in spontaneous takeovers by workers’ groups (from the autumn of 1978 onwards), typically after the business owners had fled Iran (Behdad, 2000:101-102). The institutions of Khomeini’s ‘mini-state’ were often involved. The Revolutionary Courts confiscated assets of ‘anti-revolutionaries’; the assets would be transferred to the newly-created Islamic foundations, of which the Foundation for the Oppressed (Mostazefan Foundation), the Martyr’s Foundation and the Fifteenth Khordad Foundation became the most significant. This early phase of expropriation was endorsed and sometimes promoted by Khomeini’s regime “as a means of mass mobilization” (Ibid.:102). However, once power had been consolidated this was limited and the *ad-hoc* nationalisation programme was largely halted.

It is possible to discern three broad trends which defined the level of nationalisation within the post-revolution economy of Iran. Firstly, the debate over a populist redistribution of the economy led to considerable nationalisation. Secondly, the mounting failures within Iran’s economy resulted in further nationalisation to bail out other industries. Finally, nationalisation was, to a certain extent, actually transferring previously nationalised property from one government to another. The court’s property simply became the new government’s and that of its Islamic foundation appendages.

To a certain degree, the populist leanings of the government necessitated some redistribution of wealth, i.e. nationalisation. In order to mobilise the people, Khomeini



needed to make economic promises and it was necessary to carry out at least some of these promises when the revolution finally succeeded. This had been the case in Latin American Populist revolutions and was so in Iran.

Ehteshami makes the case that rather than being an attempt at revolutionising the economy, the nationalisation of industry was an attempt to “bring back productivity as well as order and management to a large and abandoned section of the economy” (Ehteshami, 1995:86). Thus, the reasoning is partially attributable to the personal intervention of Khomeini in order to prevent economic collapse (Ibid.). In other words, in reality, the state was most concerned with bailing out the failing industrial sector by acting as a direct subsidiser, as illustrated by the formal nationalisation of those firms with high debts.

Finally, it is possible to see the nationalisation of the economy in terms of serving a similar goal as it did under the Shah (Personal Communication).<sup>64</sup> As demonstrated in Chapter 2, the Shah used his control over the economy, and especially of oil revenues, to increase his power and control over society. In a similar manner, the post-revolution government also used its dominance over the economy to further its control over society.

As under the Shah, the post-revolution government was able to maintain its dominant position over society partially through its control of the economy. In particular, it is important to note that by controlling large industries – points at which it is possible to accumulate power – the government was able to limit possible contenders. Especially for the early years of the government, this meant being able to limit possible counter-revolutionary activity.

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<sup>64</sup> Personal Communication. Discussions with Dr. Bijan Bidabadi, Faculty Member & Director of Foreign Exchange Research Department of Central Bank of Iran, Tehran, December 2005.

Nationalisation and clientelism relationships guiding behaviour extended into the financial sector. Like many developing economies, the financial sector was subject to 'repression' – government controls and policies, which suppressed market forces and directed credit to favoured groups. The provisional government had nationalised some banks in 1979 (Behdad, 2000:101-102), while the authorities introduced Islamic banking through the Law of Usury-Free Banking, approved by parliament in August 1988 (Nomani and Rahnema, 1994:178). The financial sector's performance deteriorated over the period, a result of uncertainty over the government's regulations, from 'rates of profit' (interest rates in an Islamic guise) well below market clearing rates (and well below inflation), and from poor management and regulation.

Monetary policy was subject to "fiscal dominance" as the large government deficit was "financed by borrowing from the Central Bank and the banking system" (Ibid.:181-182). The inevitable result was accelerating inflation and a plummeting currency. The authorities' attempts to offset these effects via direct price controls and multiple exchange rates only served to further economic instability.

### **3.5.3 *Bonyads***

The emergence of the large Islamic foundations (*Bonyads*) was one of the elements of novelty which came from the regime's economic policy, but they reflected long-established patterns of assigning favours on the basis of political loyalty. These semi-public bodies under clerical control have come to dominate the Iranian economy, and many also have significant asset holdings outside Iran.<sup>65</sup>

The *Bonyads* were the chief recipients of the distorted prices created by the regime, gaining access to scarce foreign exchange at subsidised prices. The foundations,

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<sup>65</sup> Behdad (2000:113) claims that the Mostazefan Foundation is "the largest economic entity in the Middle East".

essentially networks of conglomerates, were controlled by an emerging “entrepreneurial” class “who were close associates of the regime and benefited from the many privileges of this association” (Behdad, 2000:113).<sup>66</sup> Kanovsky is highly critical of the *Bonyads*’ role in the Iranian economy, arguing that although their stated purpose is:

...to use profits from [their] enterprises to provide inexpensive housing, healthcare, and other social services to the poor, [in reality much of the profits is] ...siphoned off by those in control and relatively little reaches the needy. [Furthermore], ...though the *Bonyads*’ 1992-93 budget was equivalent to nearly half of the government’s budget that year, the latter exercises very little control over these foundations, which answer only to the supreme leader [*faqih*] (Kanovsky, 1997a:7).

In personal interviews with the Chairman and Managing Director of the Audit Organization,<sup>67</sup> it was discovered that the Bonyad owns:

- 140 industrial enterprises, manufacturing products such as food and beverages, electrical appliances, construction materials, textiles and clothing, leather goods, plastics, metals and paper;
- 64 mines;
- 2,786 properties, covering agricultural, commercial or construction sites;
- 230 commercial and trading companies;
- 90 theatres and three of Tehran’s leading newspapers.

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<sup>66</sup> The *Bonyads*’ economic structure (sprawling conglomerates), their client relationship with the ruling class and their dominance of the domestic economy make them close relatives of the Korean *chaebol*. Their potential for generating macroeconomic crises – similar to the *chaebol*’s role in the 1997-8 crisis in Korea – should not be underestimated.

<sup>67</sup> Interview: Mr. Houshang Naderian, Chairman & Managing Director, Audit Organization, Tehran, December 2005.

It also owns a hospital, retail outlets, airline and shipping companies, an insurance company and a credit institution. In addition, it is involved in the construction of commercial buildings, roads and railways. It employs some 150,000 people and produces 28% of Iran's textiles and clothing, 22% of its concrete, 45% of its beverages, 28% of its rubber products and 25% of its sugar. Its annual budget is reported to be around 10 billion U.S. dollars.

The concentration and monopolisation of financial power in the hands of the Bonyad provides it with a disproportionate economic weight in relation to any single private firm wishing to obtain a share of any of its markets. Its decisions concerning production and imports have major consequences for the availability of raw materials, market prices of products and the profit margins of competitors.

Therefore, the breaking up, regularisation and eventual privatisation of the Bonyad is a necessary precondition for the emergence of a competitive and efficient business environment in Iran.

#### **3.5.4 *Evolution of Oil Policy***

The oil sector continued to dominate the Iranian economy during the 1979-89 period, although oil revenues were severely reduced by the collapse of the oil price in the mid-1980s, as oil revenues had fallen from \$21 billion in 1983 to \$6 billion by 1986. The US trade embargo and the Iran-Iraq war (particularly the 'tanker war') further impacted the already damaged economy (Kanovsky, 1997a:10).

With respect to oil sector policy, the authorities brought all oil and gas industry' activities under the auspices of NIOC, cancelling the agreements with the international

consortium and reducing the production target (Rahnema and Nomani, 1990:240). The reduction in production reflected the pre-revolution rhetoric against the Shah's oil sector policies, which Khomeini accused of favouring Western imperatives (ample, cheap oil) (Ibid.:236). As in other areas of the economy, clerical opposition to technocrats (perceived as pro-Western) and a significant brain drain resulted in the deterioration of management expertise in the sector. As early as the late 1980s, the regime was forced to reverse its initial decision to cut oil production, as the spiralling costs of the Iran-Iraq war and the economic crisis caused by the dramatic fall in oil prices took their toll (Richards and Waterbury, 1996:57-59). Since 1989, this renewed emphasis on oil and gas exports (another return to the Shah's development strategy) has become more pronounced.

Interestingly, while the government's control over oil revenue allowed it to gain dominance within Iranian society, it also forced the government to develop and maintain a relationship with the international capitalist system. This was necessary in order to secure the sale of oil and gas (Personal Communication).<sup>68</sup> In particular, it was necessary to work with the West, to some degree, even while faced with an embargo. While there was an attempt to move towards self-sufficiency within the economy, oil sales could never truly be replaced. Thus, whether or not the post-revolution government desired to separate itself from the international system, it could not possibly do so while also maintaining its place within Iran.

One of the important effects of this deterioration of the Iranian economy, especially during the 1980s, was a change in economic policy. In particular, the government sought more private sector involvement and formally announced this in 1986 (Ehteshami, 1995). The 1986/1987 oil crisis also forced the government to increase its reliance on taxation in order to continue promised subsidies.

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<sup>68</sup> Personal Communication. Discussions with Seyed Mohammad Hossein Adeli, former Iran Ambassador to the UK and present editor of *Economic Trends*, Tehran, May 2006.

Economic liberalisation continued after Moussavi's re-election in 1988. The government lifted some restrictions on the importation of certain goods. The Tehran stock exchange was reopened in the autumn of 1988. Earlier that year, the government announced a comprehensive privatisation plan in which "non-essential and non-strategic" industries would be privatised (Ibid.:97). After much debate, by 1989, the government reversed its long-standing policy against foreign borrowing and approved the borrowing of over \$2 billion over the subsequent five years (Ibid.).

The deep-rooted and self-inflicted problems of Iran's oil policy, to a major extent, stem from prolonged Washington sanctions, the Islamic Republic's ideological bent and populist policies, and the country's increased isolation from the Western diplomatic community in recent years. These elements have compounded the problems of supply, due to the nature of the buy-back contracts which have driven many potential investors away. Furthermore, with the rising demand for products in the country, population growth, as well as the addition of almost one million automobiles to the roads every year, not to mention the fuel subsidies, Iran's economy is in a dire state.

### **3.6 Conclusions**

The Islamic Revolution ushered in a period of unprecedented political and economic turmoil for Iran. The first few years of the Islamic Republic were characterised by widespread political violence and economic chaos, heightened by the invasion of the country by Iraq in 1980 and by poor external relations, particularly in the wake of the 1979-81 hostage crisis.

The revolution, which continued in the form of the Islamic-based politics of Iran, led to a fundamental tension between politics and religion. This tension was partially due to the ambiguous views of Khomeini, which reflected some ambiguities within Shi'ism

itself as well as the attempted blend between popular sovereignty and theocratic rule. This tension was pronounced when it came to economics and, specifically, the place of private property within the Islamic Republic. The initial take by the government was to nationalise much of Iranian industry, including strategic areas such as oil and gas. This statist development strategy led to chronic resource allocation problems, precipitating a sharp decline in investment.

Ideological divisions led to a policy drift on the economic front. The policy vacuum was filled by *ad-hoc* expropriation and creeping cronyism as unaccountable quasi-public conglomerates – the *Bonyads* or foundations – came to control increasing portions of the Iranian economy. These foundations – with close, but opaque, links to the ruling clerical establishment – were the chief beneficiaries of economic rents generated by price distortions, state monopolies and financial repression. Eventually, however, the internal divisions within the government and the realities of a declining economy forced some economic liberalisation.

The present perception of Iran internationally is based upon Khomeini's rule. The hostage crisis and the Iran-Iraq war, as well as events such as the invocation of a fatwa against the British writer Salman Rushdie, created the image of an aggressive or potentially aggressive and fundamentalist regime. This also marred the interactions with respect to the economy. However, there are a couple of points that one needs to take into account. First, the flexibility of the Iranian system. In other words, factionalism and the existence of several views on different policies can work in a positive way. It leaves opportunities for an array of policies, depending of course on the political timing.

Secondly, while Iran during this period was often labelled as a closed society, in fact it was not completely closed off. As has been noted by a distinguished analyst:

Iran is not a static and closed society, as it is often portrayed in the mass media. Iran is a dynamic country, and there are both positive and disturbing trends developing within it (Milani, 1997:89).

In reality, governing elites had more room for political discourse than in most Middle Eastern countries. There were factional controllers of the *Majlis* and this was critical.

With the exception of the Israeli Knesset and the Turkish parliament, Iran's *Majles* is arguably the most independent parliament in the Middle East and North Africa (Ibid.).

For instance, the *Majlis* has in the past rejected its choice of ministers; for instance, it rejected the US-trained economist Mohsen Nurbakhsh for Minister of Finance and Economy.

In total, while this chapter has leaned in the direction of analysing the Iranian state as closed, it is necessary to keep a balanced opinion. Chapter 4 will look at these factors in more detail.

The death of Khomeini in 1989 represented the end of the Islamic Republic's first revolutionary stage. Whereas, during the immediate post-Khomeini period (1989–97), leadership passed to more pragmatic and reformist figures such as Ayatollah Ali Khamenei (who took on Khomeini's role as spiritual leader or *faqih*) and Ali Hashemi Rafsanjani (who was elected as Iran's first executive President) (Ehteshami, 1995:25), theorists have identified the Rafsanjani era as the beginning of the 'Thermidor' (a reaction against the early idealism of a revolution) in the Islamic Republic, when Khomeini's radicalism was replaced by a greater willingness to compromise, particularly in the field of economic policy. Thus, more 'pragmatic' or 'realist' politicians – headed by Rafsanjani and Khomeini's successor as *faqih*, Ali Khamenei – subsequently embarked on a programme of economic reform and foreign policy detente.



This subsequent period, labelled by some commentators the Second Islamic Republic, is discussed in Chapter 6.

## **CHAPTER 4: POLITICAL ECONOMY OF OIL POLICY: 1989 TO PRESENT**

### **4.1 Introduction**

By looking at the historical background, and social and economic relations within Iranian society, as well as the dynamics of internal and external politics, it has been shown so far that there are several factors (determinants) that must be taken into account when thinking about the specific issue of oil and gas privatisation in Iran. Whilst the toppling of the Shah brought some new elements within the analysis (such as an increased role for Islam), some other features of the political, social and economic areas are still persistent. Briefly, these are factionalism (amplified by the combination of the principles of popular sovereignty and Islamic rule, and by the ambiguities within Shi'ism), clientelism and repression of any opposition.

Additionally, following a nationalistic discourse, the nationalisation and centralisation of the economy deepened, as did control over the oil and gas resources. Furthermore, the type of foreign policy pursued during Khomeini's rule created a more negative image of Iran internationally, which can be traced through to the present. There are, however, some aspects that are often glossed over or not taken into account. The diversity of opinions with respect to private property, for example, as well as other issues, has been a source of instability and political deadlock, and a sign that options are available in the Iranian society. There is now also the possibility of uttering them in the public space.

This chapter builds on the previous two historical political-economy chapters, to come closer to answering the project's question of whether there is the political will to privatise oil and gas in Iran. It will address several major sub-questions. The first sub-question is: what are the determinants of the Iranian policy of oil and gas privatisation in Iran? As with the previous chapters, this question will be answered by exploring the

internal politics (role of leaders, political makeup, etc.) external politics, and economic policies and relations.

Secondly, this chapter will answer the question as to which are the most influential constituents in the process of formulating privatisation policy? Again, this chapter will address the question by examining the major institutional constituents that determine privatisation policy. These include the executive and legislative branches of government, society as a whole, the media and religious elements. These constituents will be examined within the framework used in previous chapters. Before answering these questions, however, it will be useful to provide a brief history from 1989 to the present period. This will provide us with a frame of reference for the rest of the chapter.

#### **4.1.1 *History in Brief***

The historical period that this chapter will focus on has seen significant internal political changes and these changes, as we will explore later in this chapter, have had a significant impact on the prospects of privatisation in Iran. During this period, three Presidents have taken power in Iran and each has had their own important impact. Historically, there were some fairly significant changes in the Iranian political structure in the late 1980s and early 1990s.<sup>69</sup>

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<sup>69</sup> During the Second Republic, the Expediency Council increased from 13 to 20 members under the 1989 Constitution. It was chaired by the President and members chosen by the *faqih*. "In its current form, thus, the control of the council remains with the 'Leader-President' coalition. Despite the presence of Ahmad Khomeini, former Majlis Speaker Mehdi Karrubi, former PM Moussavi and former Prosecutor-General Mohammad Khoini'a as the Old Guard hard-liners and their counterweights in Rafsanjani and Ayatollah Yazdi and Mahdavi Kani in the council, it is clear that the 'institutional' appointments ensure a bias towards the realists' (or pragmatists') line" (Ehteshami, 1995:47). Constitutionally, besides the six Islamic jurispudent members, the heads of the three branches of government and the Minister of the Interior, the Cabinet Minister and Head of the Majlis Committee concerned with the matter under discussion were always present. The clerical establishment continued. It was estimated at between 90,000 - 200,000 members and around 200 Ayatollahs. "[Clerics] continued to form the backbone of post-Khomeini Islamic

In August 1989, Ali Akbar Hashemi Rafsanjani, the long time speaker of the National Assembly, was elected President with an overwhelming majority of the vote and Ayatollah Ali Khamenei took on Khomeini's role as spiritual leader or *faqih*. Nateghnouri's 1993 win was much more modest and he lost to the moderate reformer, Mohammad Khatami, in 1997. Khatami was re-elected in 2001. President Mohammad Khatami tried to restore normality both in Iran and in its relationships with foreign countries. Elected with 69% of the vote in the May 1997 elections, and again, with some 60% of the vote, in the 2001 elections, he certainly had the mandate of Iran's youthful population.<sup>70</sup> However, in 2005, the conservative mayor of Tehran, Mahmoud Ahmadinejad was elected President, again swinging the pendulum of reform back towards the conservatives.

## 4.2 Internal Politics

The domination of foreign powers has had a profound effect on the mindset of the political elite of Iran. It has etched the fear of being dominated into the memory of the people to the point where it erupted in 1979. The clerical establishment has lived with a history of foreign manipulation and interference in the internal politics of modern Iran. Perhaps it would not be too difficult to understand the animosity and apprehension the

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Republican Iran" (Ibid.). Ehteshami's table summarises the various agencies of formal power in Iran as of 1991:

AGENCY	FOUNDED	FUNCTION
<i>Faqih</i>	1979	Spiritual leader
Executive Presidency	1989	Executive leader
Cabinet	1979	Control of ministries
Assembly of Experts	1979	Nominate and choose the <i>Faqih</i>
Council of Guardians	1980	Ratify <i>Majlis</i> legislation and supervise elections
<i>Majlis</i>	1980	Approve government policy
Expediency Council	1987	Arbitrate between <i>Majlis</i> and CoG
Reconstruction Policy Making Council	1988	Formulate reconstruction policies
Head of Judiciary	1989	Oversees courts
Joint Chiefs of Staff	1991	Co-ordinate defence policy

<sup>70</sup> More than 40% of the country's 65 million citizens are under the age of fifteen.

decision-makers felt towards their foreign actors and counterparts. The 'Great Game' that Russia and Britain played for control over Central Asia in the nineteenth century left scars on generations of Iranian leaders and deeply instilled a determination to insulate Iran against foreign influence. This longstanding suspicion developed into deep ambivalence among the modern clerical establishment within the political hierarchy of Iran. To this day, the internal politics of post revolutionary Iran is directed by this dictum.

#### **4.2.1 *Role of the Leaders: Has Anything Changed From Khomeini's Time?***

Khomeini was a strong and charismatic figure in control of the state apparatus. His personal beliefs (including his shifting positions between several views within Islam) impacted on the direction of policies over a decade. The following analysis aims to identify the role of the subsequent leaders of Iran in shaping policies.

One important issue that one needs to take into account after the death of Khomeini, is the more obvious separation between the institution of the spiritual leader and that of the President. The latter's role has been (at least legally) strengthened with enlarged powers under the amended post-Khomeini constitution. For example, the post of Prime Minister was abolished and some executive powers were transferred to the presidency, creating an uncomfortable partnership between the elected President and the supreme leader. Since 1989, the President has appointed the government, although all ministers must be approved by the *Majlis* before taking office. The supreme leader still enjoys primary control over many organs of state and retains the right to appoint key officials such as heads of the judiciary, the broadcast media, the armed forces and various revolutionary bodies (Anon, 2005b).

Thus, the lack of an overlap between the political leader and the spiritual one is an important aspect of Iranian politics since 1989. Although the *faqih* still has considerable influence, having the power to intervene on any issue, including specific pieces of legislation, the final outcome of a policy is more about bargaining (as in the case of political bureaucracies in secular and democratic states) rather than outright imposition of the former's views.

The religious figure who has been influential upon the Iranian political environment is Ayatollah Ali Khamenei. He was appointed as supreme leader for life in June 1989, succeeding Ayatollah Khomeini, the founder of the Islamic Republic. He served under Ayatollah Khomeini holding different functions,<sup>71</sup> and was one of the founders of the Islamic Republic Party in 1979. He also served two consecutive terms as President in the 1980s.<sup>72</sup>

Khamenei's influence is seldom exercised explicitly, but many times it is exercised behind the scenes. He has aimed to preserve stability and to contain the power struggle between reformist and conservative factions, but as the schism in the political elite has widened he has increasingly backed the conservatives (Anon, 2005b). In other words, Khamenei, although not formally aligned to the grouping, is viewed as being broadly supportive of the conservative position on most issues. Over the years, he has come into conflict with the former Presidents Ali Hashemi Rafsanjani and Mohammad Khatami, as well as with other reformists (Wells, 1999:30; Owen, 2000:112; BBC, 2005b).

Rafsanjani, elected President in 1989, is a figure whose affiliations are harder to place. Owen locates him in the "reformers" camp; a third faction made up of "moderates"

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<sup>71</sup> He served in the Central Council of the Party, also as Deputy of the Ministry of Defence, representative of the Council in the Ministry and Commander of Islamic Revolution's Guards Corps. For more details see Iranchamber (2005).

<sup>72</sup> In 1981, Hojatoleslam Khamenei was elected President of the Islamic Republic with 95% of the votes cast in his favour.

(social liberals with “third way”-style economic leanings), former radicals and pragmatic careerists (Owen, 2000:112-3).<sup>73</sup> Abrahamian (1991; 2001:119) characterises Rafsanjani’s politics as closer to the conservative position and essentially similar to Khamenei’s, particularly in the field of economic policy. Ehteshami argues that, at least initially, Western analysts tended to place Rafsanjani in the *Maktabi* camp, but that latterly Rafsanjani (and Khamenei) have been given a subset of their own – the “technocratic coalition” (Ehteshami, 1995:18).

However, Ehteshami holds that this group did not form a “homogeneous and cohesive force”, but rather attempted to forge a pragmatic approach to policy formulation that “led to a sense of insecurity among the governing ranks of the republic, which in turn bred opportunism within the elite” (Ibid.). Rafsanjani now enjoys a position of power and influence at the head of the Expediency Council, from which, according to Owen, he has ensured “that attacks on [his successor as President] Khatami’s leadership could be blunted and contained” (Owen, 2000:113). This view supports the proposition that Rafsanjani’s political instincts are essentially reformist.<sup>74</sup>

During his first time as President, Rafsanjani cemented a reputation as a corrupt and power-hungry politician (Personal Communication).<sup>75</sup> He crushed personal freedoms and presided over a sharp economic downturn. He ushered in a particularly aggressive phase of Iranian sponsorship of terrorism, including alleged roles in the bombing of a Jewish community centre in Buenos Aires in 1994 that killed more than eighty people, and in the assassinations of several Iranian exiles, including former Prime Minister Shahpur Bakhtiar in 1991.

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<sup>73</sup> Rafsanjani undoubtedly qualifies as a pragmatic careerist in this context.

<sup>74</sup> Further evidence of this view is provided by Wright, who points out that Rafsanjani’s daughter, Faezeh Hashemi, was the publisher of *Zan*, a woman’s magazine which took up a campaigning position on social issues until it was banned in 1999 (Wright, 2000).

<sup>75</sup> Personal Communication. Discussions with Dr. Bijan Bidabadi, Faculty Member & Director of Foreign Exchange Research Department of Central Bank of Iran, Tehran, December 2005.

Khatami, who was elected state President in 1997, comes from the relatively small moderate wing of the clerical establishment. He had enjoyed a ten-year ministerial career in the 1980s and early 1990s, but had fallen foul of the then-dominant conservatives in 1992. Khatami had been a supporter of Ayatollah Montazeri, who was Khomeini's designated successor as *faqih* up until March 1989 (Wells, 1999:36). Montazeri fell out with his former mentor after criticising the regime for the slow pace of political reform and its autocratic leanings, resulting in his replacement by Khamenei, a then relatively junior cleric who was hastily upgraded to Ayatollah status (Ehteshami, 1995:33).

Khatami's campaign focused on the need for political and social reform, calling for the establishment of an "Islamic democracy" (Owen, 2000:113). Khatami drew support from a disparate range of groups, all outside the conservative camp and many of whom the Islamic Republic's power-brokers had sought to suppress or ignore in the past: secularists, Islamic leftists and women (Ibid.:112). However, despite a significant electoral mandate in both the 1997 and 2001 elections, the President struggled to build a working coalition to implement his liberalising agenda. In large part, this was due to "the fact that the Majles [before 2000] and many of the major organs of government were controlled by his conservative opponents" (Owen, 2000:113).<sup>76</sup>

Khatami also pushed for economic reform, and indeed the administration implemented structural reforms in a number of areas (IMF, 2003). This success in the economic sphere contrasts starkly with the failure of Khatami and his allies in the *Majlis* (before 2004) to advance their social reform agenda. Powerful conservative opposition in the

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<sup>76</sup> As demonstrated by the moderates' subsequent control of the *Majlis* (2000-2004), the critical levers of power in conservative hands were the Council of Guardians, the Expediency Council, the *faqih*-ship and the judiciary. Iran's (1989) constitution, which granted veto power to the Council of Guardians and gives the Expediency Council the key role of adjudicating between parliament and the Council of Guardians, effectively sidelines parliament. Hence Milani's characterisation of the Islamic Republic as a regime based on "*limited* popular sovereignty" [my italics] (Milani, 1997:82).



Council of Guardians and the Expediency Council, as well as pressure from Khamenei, blocked Khatami's attempts at reform.

Mahmoud Ahmadinejad, the elected President in June 2005, was the former mayor of Tehran. His Presidential campaign focused on poverty, social justice and the distribution of wealth inside Iran, as well as being against corruption. However, his conservative take on reforms led, for example, during his office as mayor to curtailing many of the reforms put in place by the moderates who had run the city before him. Despite the fact that he was the first non-cleric President for 24 years, Ahmadinejad points to the fact that Khomeini's legacy is still strong. His populist tone reverberates Khomeini's, and his support in the *Majlis* reflects this orientation (BBC, 2005c).

Although not an extremist, he is rather conservative on an array of domestic issues (BBC, 2005d). In his own words:

On the domestic scene, government policies will be based on moderation and any extremism will not only be avoided, but will be dealt with seriously (Ibid.).

His role in shaping the views of the Western world (EU, UN and the US) on Iran has been already tested on the issue of the nuclear energy.<sup>77</sup> The suspicion that he was one of the students involved in the hostage taking in 1979 contributes to a negative image towards the Iranian political establishment. The President seems to be in agreement with Khamenei more than with the former Presidents (BBC, 2005c). However, he has difficulty in imposing this will on the *Majlis*, as in the case of getting agreement on the new minister of the oil industry (Anon, 2005c).

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<sup>77</sup> Ahmadinejad also drew widespread criticism from the West when he told a conference in Tehran that the state of Israel should be "wiped off the map" (BBC, 2006).

One can assert that the *faqih* still exercises important power on the decision-making process or on the outcome of specific laws and policies. However, the clearer separation after Khomeini's death between the institution of the President and that of the religious leader has created important opportunities for reform and expression of alternative (i.e. reformist) views. Presidents like Khatami did succeed in imposing a different type of outlook on Iran's economic (liberalisation) and social policies, despite many limitations (e.g. limited roles for women). Support from amongst the members of the *Majlis*, the Council of Guardians and the Expediency Council,<sup>78</sup> is also crucial in the implementation of laws.

#### 4.2.2 *The Political System: Features*

As discussed earlier, Iran's political complexity comes from a blend of modern Islamic theocracy with elements of the popular sovereignty of democracies. This is reflected in the type of institutions that coexist in Iranian society: a network of unelected institutions controlled by the highly powerful conservative supreme leader is countered by a President and parliament elected by the people. The purpose in highlighting this is to demonstrate the multiplicity of the decision-making bodies within the government which have varying degrees of political will in reforming the existing institutions within Iran.

Figure 4.1 illustrates the composition of the system and their relation to each other (Buchta, 2000; BBC, 2005b). This repartition of power becomes more important after

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<sup>78</sup> The Expediency Council mediates disputes between the Council of Guardians and the *Majlis*, and tends to rule on the side of the former. Rafsanjani took over as Chairman of the Expediency Council when his second Presidential term ended in 1997, and he has used the post to ensure that he continues to command influence at the heart of the Islamic Republic. The Assembly of Experts is an elected all-clerical body with the primary task of selecting the supreme leader and the members of the Council of Guardians. The Assembly can also theoretically dismiss the supreme leader if he fails to meet specific criteria or becomes unable to execute his duties satisfactorily (Economist Intelligence Unit (2005).

1989 due to the disjunction between the institution of the President and that of the supreme leader.

**Figure 4.1: Composition of the Iranian Hierarchy**



Source: Buchta (2000).

The wrangling between the above elected and unelected institutions speaks of the common trends with respect to internal politics that have emerged before 1989. The most salient are a persistent disjunction between state and society and endemic political factionalism. These two factors continue to play critically important roles in the determination of Iranian politics, as we shall see in the next sections. Both of these overriding features of the Iranian political landscape have had important effects on the political economy of privatisation in Iran. What we will come to see is that both factors are connected and the evolution of Iranian politics has been towards a distinction between conservative and liberal views of the world. This distinction has been played out not just in Iran but in many nations around the world and, in particular, in the Middle East. Thus, while we will begin by focusing on the continuity with the previous eras we have explored, the final conclusions will be based on this conservative-liberal

breakdown. Importantly, this breakdown does not just hold for internal politics, but has also determined the arguments over foreign and economic policy and, in particular, the potential for privatisation of the nationalised state industries.

### **4.2.3 The Relationship Between State and Society**

An important element that has been more visible since 1989 is the participation of society in politics. Although many times limited to the casting of a vote or sporadic protests, this should be considered as an improvement from the previous decades. The spread of information technology and satellite TV has contributed to the creation of a more active and aware civil society.

The fluctuation in the voting percentage is reflective of Iranian society's disinterest in the affairs of the state apparatus. Yet, disenchantment is not characteristic only of Iranian society. One could say, however that the support does reflect a perception on behalf of Iranian society that its contribution (through the election of a specific candidate) might be important in shaping the future of Iran.

The lack of political will and the difficulties in the implementation of laws within the Iranian political system, as well as the continuous conflict between the conservative and reformist camps, can explain why the overwhelming majority that voted for Rafsanjani in 1989 did not come back with the same force in the 1993 elections (Personal Communication).<sup>79</sup>

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<sup>79</sup> Personal Communication. Discussion with Dr. Narsi Ghorban, Managing Director, NarKangan (NGTLC) Gas to Liquid International Co., Tehran, December 2005.

The gap between the government and society deepened and reached a climax in July 1999. During this month, there were large-scale anti-government protests in the streets of Tehran which lasted more than a week. The police and pro-government vigilantes were needed to disperse the crowds (personal observations at that time). In a country whose government had only recently taken power in a similar way, such protests were extremely ominous.

This post-1989 period reflects a change, or at least a recognition on behalf of some parts of society regarding their different views from those of the Council of Guardians. In June 2001, Khatami's re-election signalled this fact. One should not assume, of course, an homogenous outlook by society. As with politics, a complex variety of opinions could be found amongst the common people. After Khatami's election, the more conservative elements in the Iranian government invoked the support of the more conservative elements in society (Personal Communication).<sup>80</sup> The conflict between different views was dealt with by the same mechanisms as those used by the previous authoritarian regimes of the Shah and Khomeini. Liberal newspapers, representing the views of the reformers, were banned. Many of the reformist candidates were banned from running in parliamentary elections. The Council of Guardians enforced discretionary measures to counter societal preferences for different political candidates, as in the 2005 elections.

The bad state of the economy, which affected the lower and working classes, allowed for populist discourses to become appealing. Ahmadinejad's populist views appealed to those who felt cheated by the trajectory of the Iranian economy and who had not gained from rising oil prices. These same social groupings were less concerned with the sort of social liberalisation which those in Tehran, and in many Western countries, found so

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<sup>80</sup> Personal Communication. Discussion with Dr. Narsi Ghorban, Managing Director, NarKangan (NGTLC) Gas to Liquid International Co., Tehran, December 2005.

important. Corruption is a salient element that affects the relationship between the state and government.

Another factor that has come to play an increasingly significant role in reshaping the interaction between society and politics in Iran is demographics. The fact that more than 50% of the Iranian nation is now under the age of eighteen (Personal Communication),<sup>81</sup> has meant that the majority of its citizens were not alive during the revolution. The existence of an important category of society which has not been directly affected by the revolutionary discourse only means that this category is more willing to pay attention to reformist, liberal tendencies. The participation of this part of society was politically significant in the 1997 and 2001 elections.

#### **4.2.4 Factionalism**

Factionalism remained a trait of Iranian politics throughout the presidencies of Rafsanjani and Khatami, and by the signs so far it will impact on the presidency of the newly elected Ahmadinejad (Owen, 2000; Anon, 2005c).

The fascinating and important thing about Iranian politics is the different combination between socially conservative or reformist agendas and liberal or conservative/socialist economic programmes. Examples of such combinations are briefly presented here. One is the left-leaning faction that favoured redistribution and social justice, alternatively referred to in the literature as “hard-liners”, “Islamic socialists” or “radicals” and known in Iran as the “Imam’s Line” or *Maktabis* (Ehteshami, 1995). They managed to initially rally the greatest electoral support and were well represented in the *Majlis*, at least until

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<sup>81</sup> Personal Communication. Discussion with Dr. Narsi Ghorban, Managing Director, NarKangan (NGTLC) Gas to Liquid International Co., Tehran, December 2005.

the 1992 elections.<sup>82</sup> The conservative faction, initially centred on the *Hojatieh* society and later organised through the Society of Combatant Clergymen in Tehran (*Ruhaniyat*), has been aligned with powerful bazaar merchants and advocates a more economically liberal and socially conservative agenda.<sup>83</sup>

A new coalition has been created in opposition to the conservatives, as a result of the defection of the political moderates and pragmatists from the conservative camp and the increasing pragmatism shown by the former hard-liners in terms of economic policies. It was this coalition, which can be broadly characterised as liberal,<sup>84</sup> that backed Khatami's Presidential campaign which focused on social reforms.

The recent election of Ahmadinejad may change the factional politics of Iran, but this is doubtful. Rather, it is more likely that the distinction between 'conservative' and 'liberal' will come to dominate decision-making. However, we may see a rewriting of this distinction along the lines outlined above – i.e. a separation between social and economic issues. The conservatives' victory in the 2004 *Majlis* elections, following their blocking of most of the moderate candidates, cemented their victory (Muir, 2004). However, despite the fact that parliament is dominated by conservatives, many of whom supported Ahmadinejad against Rafsanjani in the second round of the Presidential elections, in June 2005, since taking office the President does not seem to be able to win the necessary support for decisions concerning the oil industry. It is now only a minority that supports the President (Anon, 2005c).

The persistence of factionalism makes the political environment rather instable and makes difficult the decision-making process and then implementation of policies. On

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<sup>82</sup> Since the 1990s, the left's main political vehicle has been the Society of Combatant Clergy of Tehran (*Majma-e Ruhaniyat-e Mobarez-e Tehran*, or simply *Ruhaniyat*). See Wells (1999).

<sup>83</sup> The *Ruhaniyat*'s full title is *Jameh-e Ruhaniyat-e Mobarez-e Tehran* (Wells, 1999).

<sup>84</sup> Khatami had been forced out of his former ministerial position by the conservatives in 1992 (Wells, 1999).

the positive side, as a form of political pluralism, it allows the expression of a variety of views. However, as will be demonstrated in the next section, due to variable inclinations among the political elite and differing levels of political will for executing the reforms agreed and approved by the very same individual opinion formers, reaching a consensus and bringing harmony is a formidable task.

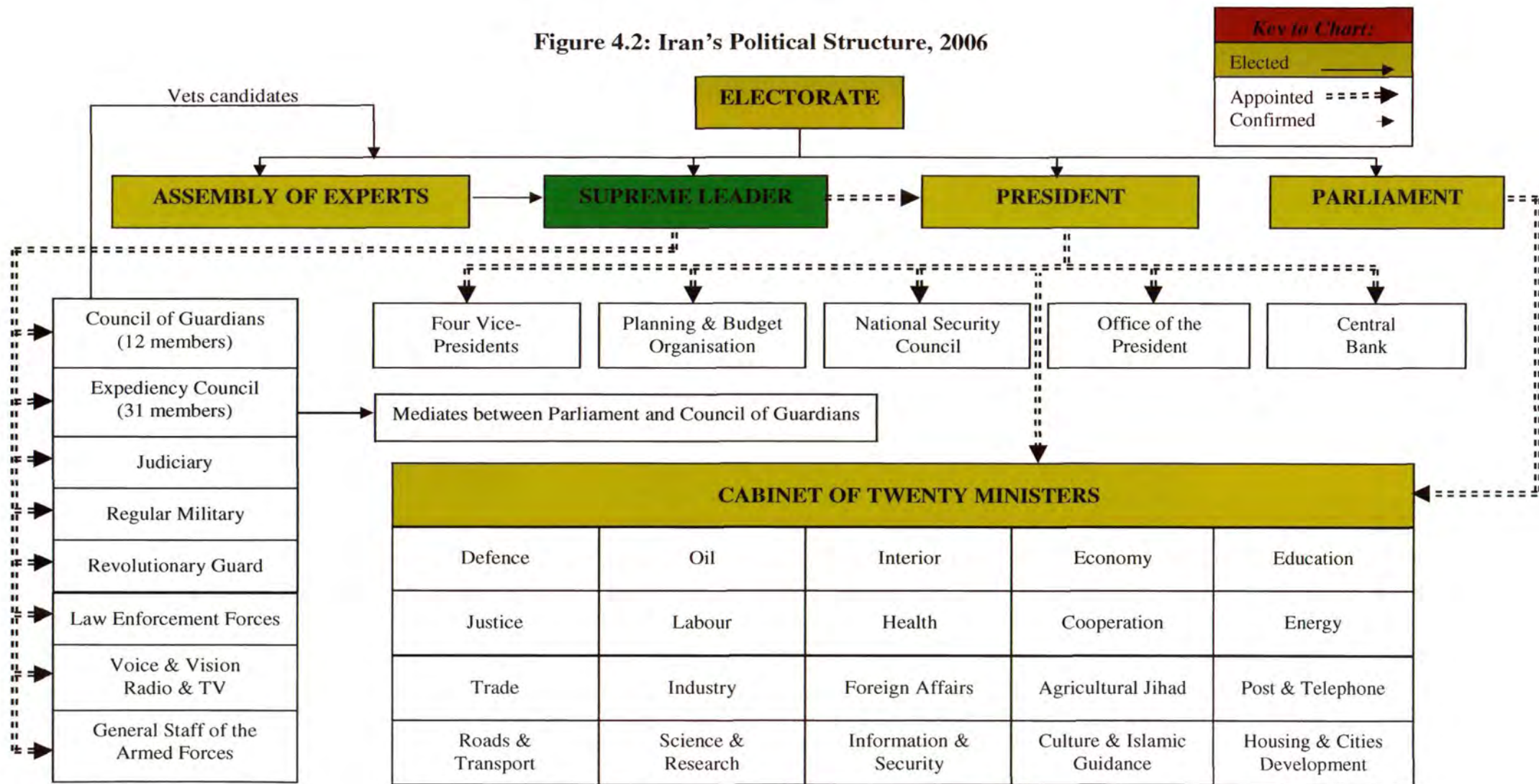
**Table 4.1: Iran's Current Political Leadership (2006)**

Name	Title
<b>LEADERS:</b>	
Ayatollah Ali Khamenei	Supreme Leader ( <i>rahbar</i> )
Mahmoud Ahmadinejad	President
Ali Akbar Hashemi Rafsanjani	Chairman of Expediency Council
<b>KEY MINISTERS:</b>	
Parviz Davudi	First Vice-President
Mohammed-Reza Eskandari	Agriculture
Masoud Mir-Kazemi	Commerce
Mohammed-Hossein Saffar-Harandi	Culture & Islamic Guidance
Mostafa Mohammed-Najjar	Defence
Davood Danesh-Jafari	Economy & Finance
Ali-Asghar Fani	Education
Parviz Fattah	Energy

Source: Economist Intelligence Unit (2006).



Figure 4.2: Iran's Political Structure, 2006



Source: The Economist Intelligence Unit (2006).

### **4.3 External Politics**

The 1990s and early twenty-first century have been times of increased international political and economic involvement for the Iranian state. Throughout this period, there have continued to exist the same foreign policy background issues that have plagued the Iranian state since the revolution and even before then. In particular, the Iranian state's and society's distrust of, and tense relationship with, the West and (especially) the US, has continued.

UN sanctions have now been imposed and, though far from being decisive, they sent a troubling signal to the political elite in Tehran who had counted on Russian and Chinese support. Furthermore, less visible US efforts to curb Iran's access to the international banking system has made foreign direct investment or the purchase of shares in privatised industries more precarious.

Beyond the background issue of the Iranian state's opposition to the West, three major foreign policy issues have arisen which have had a major influence on the Iranian privatisation policy. The first is the Gulf War between Iraq and the US and its allies in 1991. The second is the war on terror, including the invasion of Afghanistan and Iraq. Finally, the Iranian government's involvement in obtaining nuclear technology has had a major influence on not just political but also economic policies.

This section now addresses each of these foreign policy issues and discusses them in relation to the past interactions of Iran with foreign actors.

#### **4.3.1 *The Gulf War***

Iran's foreign policy has been at times contradictory, in that it has not taken advantage of international circumstances (e.g. the war against Iraq) to pursue an aggressive policy

towards long-standing enemies like Iraq (Personal Communication).<sup>85</sup> This is particularly interesting, because it tells us about the Iranian political scene more broadly with the emphasis put on other values. Thus, during the Kuwait-Iraq war (1990-1991),<sup>86</sup> Iran limited its actions to condemnation of the US, but otherwise remained neutral despite the fact that Iran had only recently finished its war against Iraq. It refused to take part in the multinational invasion of Iraq. Furthermore, it allowed Iraqi aircraft to land within its territory and did allow refugees across its borders.

This was exceptional among the region. Egypt, Syria, Saudi Arabia and other nations in the region had all taken part in the invasion. Unlike the more recent US-led war against Iraq, it was unlikely that there would have been any detrimental effects from a societal perspective in joining the West.

The Iranian attitude and choice of action with this particular event pointed to the fact that sovereignty and solidarity with Islamic countries in general is something that they wanted to show they cared about. The anti-American discourse was also an important determinant and, albeit as said, on this particular occasion, rallying with the invaders would not have alienated many groups of Iranian society.

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<sup>85</sup> Personal Communication. Discussions with Dr. Mehdi M. Behkish, Secretary General, International Chamber of Commerce-Iran, and Associate Professor in Economics, December 2005.

<sup>86</sup> Iraq invaded Kuwait in August 1990. Saddam Hussein had at least a threefold plan for the invasion: to obtain Kuwait's large oil reserves, cancel Iraq's existing debt with Kuwait, and gain a stronger regional position in the balance of power. Immediately after the invasion, the United Nations condemned it and ordered Iraq's withdrawal. In order to protect Saudi Arabia from the possibility of further aggression, the US and other nations sent forces to Saudi Arabia as a deterrent force. The United Nations Security Council authorised the use of force against Iraq in November 1990. By January 1991, the international forces had grown to around 700,000 troops. On 16 January 1991, the counter-invasion of Kuwait, known as Operation Desert Storm, began with US air strikes. Hostilities were over by 28 February 1991, when the US called a ceasefire. By this point, the Iraqi military had completely collapsed.

#### *4.3.1.1 Hezbollah*

Iranian foreign policy against Israel, for example, took both overt discursive aggression and covert support for groups that were engaged in the fight or opposition to Israeli actions abroad or inside the Israeli state. Support of Hezbollah, the Party of God, was such an example.

Hezbollah formed around a group of Shi-ite clerics in order to fight against Israel's invasion of Lebanon in 1982. Before this, the restively weak Shi'as in Lebanon had coalesced around the Amal movement, a largely secular and relatively moderate group. Hezbollah drew the majority of its support from the more radical members of the Amal group. It was based in the Bekaa Valley, southern Lebanon (site of the invasion) and southern Beirut. Beyond its desire to drive out the Israelis, Hezbollah also wanted to create an Islamic state.

Hezbollah was and is a cross between a terrorist organisation, militia, guerrilla insurgency and proto-government. It fought in Lebanon's fifteen year civil war, which lasted from 1975 to 1990, as other militias did. At times it even fought against the Amal group. In parallel, it fought the Israelis until their state's withdrawal in 2000. Hezbollah is also a service provider in Lebanon, bringing many of the traditional government welfare programmes to the Lebanese people, including, for instance, medical care. More recently, Hezbollah has emerged as a viable political party in Lebanon. At the same time, Hezbollah became adept at using terrorist tactics, including suicide bombers of various sorts. For this reason, Hezbollah was officially classified as a terrorist organisation after the 9/11 attacks (CNN, 2003).

From its foundation, Hezbollah has had close support from Iran. Hezbollah's Shi'a basis and animosity towards Israel made it a natural ally of the new post-revolution Iranian state. Iran has provided Hezbollah with various forms of support, including both logistical support (such as the supply of weapons) as well as ideological support (in the

form of borrowed ideology). Support has traditionally come through the Revolutionary Guard. Hezbollah has been used as a front for Iran's policy towards Israel, which includes promoting the Israeli-Palestinian conflict (Globalsecurity, 2005). Though Hezbollah has at times been directed by Iran, there are cases in which the group has acted without Iran's consent (Ibid.).

This type of support enhanced the West's negative perception of Iran.

#### ***4.3.2 The War on Terror and the Axis of Evil***

Public sector reform and privatisation are public policy issues that are always embedded in other issues pertaining to structural adjustments, degrees of state economic intervention and the regulation of markets (Suleiman and Waterbury, 1990). Naturally, it would become an artificial exercise to separate out political issues, public resource allocation, the provision of collective goods and the distribution of wealth in society, from the larger policy context. Public sector reform and privatisation never take place in isolation from broader efforts at macro-economic and political adjustment.

Whether justified or not, but certainly building on the negative perceptions already existing about Iran internationally and the belief that Iran was a state-sponsor of terrorism, the US's President, George W. Bush, included Iran within a new Axis of Evil (aside Iraq and North Korea) in his 2002 State of the Union speech. It has served as a verbal reminder of the tense relationship that exists between the US and Iran. Whereas during the mid-1990s, it seemed that there could be a *détente* and even a revitalisation of US-Iranian relations. The Axis of Evil speech demonstrated that, at least from the US' perspective, this would be impossible in the near future.

The consequence of this, along with the sanctions imposed by the US, has been to drive the potential investors interested in taking a stake in the development of the Iranian oil and gas industry away from badly needed foreign direct investments.

### 4.3.3 *The War in Iraq*

The war in Iraq should be regarded within a broader context, that of the previous foreign policies of both Iran and the US in the region; the former being of non-interference and the latter of balancing.

Iran continued its politics of non-interference in neighbouring Iraq as it did in the Gulf War. However, the situation became more complex, as the war in Iraq evolved into a classic insurgency-counterinsurgency war (Personal Communication).<sup>87</sup>

Iraq is dominated by three separate groups; the Shi'a majority in the southern areas of the country, the Sunni minority in the middle areas and the Kurds dominating the north of the country. There is significant mixing of the groups throughout and, in particular, in and around Baghdad. The secular, socialist Baath party ruled Iraq from 1963 until their leader's ousting in 2003. The party, and its leader, Saddam Hussein, was largely Sunni dominated.

This Sunni-dominated government served as a convenient counterbalance to the Shi'a-dominated Iranian government after the revolution in 1979. As has been extensively documented since the two invasions of Iraq in the last fifteen years, the US backed Iraq militarily and otherwise in its war with Iran.

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<sup>87</sup> Personal Communication. Discussion with Dr Jafar Ghamat, Lecturer, Tehran Azad University, December 2004.

This backing, however, ended with the Cold War and Saddam Hussein's invasion of Kuwait in 1990. The effect on US foreign policy was to create a policy of 'dual containment' in which the US stopped balancing one or the other power off each other, but instead attempted to keep both powers occupied. The major instruments of this policy were economic and political sanctions. The Iranian sanctions had been in existence since the revolution and storming of the US embassy; while the Iraqi sanctions were instituted after the war in Iraq in order to dampen Hussein's ability to produce weapons of mass destruction and to punish his government for its refusal to allow weapons inspectors full access.

This balance between Iran and Iraq and, by extension, between Sunni and Shi'a Muslims in the Gulf region, has become an important factor in Iranian-Western relations since the war in Iraq and institution of a new government. While the permanent constitution of Iraq is not yet in place, the state has already become based upon a democratically elected representative government. This means that sheer numbers of persons will determine the leadership of the country. Since Iraq has a majority of Shi'a Muslims, the era of a balance between a Sunni-dominated Iraq and Shi'a-dominated Iran is over.

The rising concern of some US-based analysts is that Iran may exert undue influence on Shi'a-dominated Iraq (Personal Communication).<sup>88</sup> Such a situation would, assumedly, threaten the regional balance of power and potentially have more global ramifications. While such a situation is not visibly occurring in Iran-Iraq politics, it cannot be completely discounted. However, this chapter will nevertheless not focus on the reality of Iran-Iraq internal political influence but on the effects that the impression of such influence has had on both Iranian foreign policy and the US's and other states' foreign policies towards Iran.

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<sup>88</sup> Personal Communication. Discussions with Dr Mustafa Zahrani, Former Director of the Institute for Political and International Studies, December 2004.

The balance of power between Iran and Iraq clearly has, and will continue to have, an effect on Iranian foreign policy. Perceived or real threats from an Iraq which has a large US presence forces both policy-makers and society as a whole to fear the possibility of attack. These fears are reinforced by situations such as the reported US reconnaissance missions. Combined with this offensive threat is the fear that Iraq could become a 'failed state' if a civil war were to occur. For Iran, which already borders one failed state (Afghanistan) this leaves another, and in some ways, more dangerous threat. In either case, Iranian foreign policy is, and will continue to be, directly affected by changes in Iraq.

The effects of paranoia over Iranian involvement by the US have been to create a more aggressive approach towards Iran. This has been most obvious in the US's reported special forces and other reconnaissance missions in Iran over the past year (Personal Communication).<sup>89</sup> However, this issue cannot be divorced from the more prominent factor of Iran's involvement with nuclear technology.

#### **4.3.4 Nuclear Technology**

This section highlights the distractions which delay the privatisation programme in general and reforms in the oil and gas sector in particular. It argues that Iran's depleting oil reservoirs, the government's long neglect of proper well maintenance in the oil producing fields, growing domestic demand for fuel products, inadequacy of domestic investment, and lack of access to foreign credit and technology have resulted in a petroleum crisis under which oil exports (the lifeblood of the Iranian economy) are likely to vanish in less than a decade (Amuzegar, 2007).

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<sup>89</sup> Personal Communication. Discussions with Dr Mustafa Zahrani, Former Director of the Institute for Political and International Studies, December 2004.



While the Iranian nuclear programme has been going on for years, it has recently taken on increasing importance in world politics, especially within the new global context of preoccupation on behalf of the US with the so called 'rogue states'. The accusations over Iran's uranium enriching programme, that might lead to the construction of a nuclear weapon, are directly linked to the international reputation of Iran, especially since 1979, as an unreliable and potentially aggressive state. There have also been charges of Iran's intent to produce long-range missiles. The situation has led to extensive negotiations between Iran and Britain, France and Germany.<sup>90</sup>

Iran's nuclear ambitions may have a considerable effect on the future economic situation. In particular, the negotiation process may lead to benefits for Iran if it plays its cards right. Specifically, the US has hung the carrot of membership of the World Trade Organisation (WTO) over Iran's head as a potential exchange for not going nuclear (Personal Communication).<sup>91</sup> On the other hand, economic sanctions and even an embargo could be used to ratchet up the pressure on Iran. In either case, the effects on the Iranian economy could be disastrous.

#### 4.4 Economics

Iran needs to revive its economy and address the acute problems of unemployment. High oil prices have provided the political elite with revenues far above and beyond their expectations. This in turn has given them the luxury of providing some breathing space before the patience of those young unemployed or underemployed becomes

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<sup>90</sup> It is not clear what the solution to the problem is. As one analyst puts it: "Western options range from the poor to the abysmal. Military approaches are relatively easy to dismiss. Iran is simply too big to invade, and the United States is militarily overstretched and diplomatically unpopular even with its traditional allies because of the war in Iraq. A narrow strike on Iranian nuclear facilities similar to what Israel did in Iraq in 1981, when it destroyed the Osirak nuclear reactor and set back Iraq's bomb, would probably fail, as Iran has dispersed its facilities" (Byman, 2005).

<sup>91</sup> Personal Communication. Discussions with Seyed Hossein Mousavian, former Speaker for the Supreme National Security Council, Tehran, November 2004.

exhausted. In the recent city council elections of mid-December 2006, where the turnout was a hefty 60% of the voters, the population at large showed their displeasure by voting against the President's (Ahmadinejad) list of candidates. The President, who has only been in office for nineteen months, has failed in his campaign promise to put the revenue generated from oil on the table of every Iranian family.

Iran is dependant on its oil and gas exports. According to a recent report released by the IEA in its *World Energy Outlook through to 2030* (Clist, 2006). Iran will need to attract foreign investment and technology. The IEA estimates that Iran will need approximately US\$200 billion to enable its oil industry to keep the current production rate through to 2030. With further and tightening sanctions looming over its head, it seems quite hard to imagine any foreign investors being willing to provide the necessary finance and/or technology for Iran to make any progress. In short, it is incumbent upon the current administration to take a less confrontational approach to its foreign policy, enabling it to attract investments and avoid sanctions which could cripple its economy.

With the rising demand for, and slowly rising supply of, major energy products, the Islamic Republic and its populist rhetorical reasoning for its oil industry ills are reaching a critical level. On the demand side, by paying the highest energy subsidies among the 22 countries in the Middle East and North Africa, the government has artificially raised consumer demand for various energy products far beyond international norms.<sup>92</sup> With gasoline and other fuels sold at a fraction of their world averages, total yearly energy subsidies in Iran, according to a major newspaper report based on the oil ministry's figures, range between \$30 billion and \$42 billion a year (Amuzegar, 2007), or 16-23% of GDP, depending on f.o.b. prices in Iran's southern ports, or the prevailing consumer prices in Europe. As a result, Iran's appetite for the highly subsidised fuel products has arguably become the world's highest (with annual consumption of electric power, natural gas and gasoline growing by 7%, 9% and 12%

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<sup>92</sup> Personal Communication. Discussion with Mr M.A. Ala, March 2007, London.

respectively), while its population is growing by about 1.55% a year, and real per capita income by less than 4%. With most fuel prices at about one tenth of those in neighbouring countries, an estimated \$1 billion US dollars worth of energy products are annually smuggled out of the country (Ibid.).

#### **4.4.1 *Economics and Islam***

The Iranian economy has, since the 1979 Islamic Revolution, been in a state of continuous crisis that has been engendered largely by the conflicting political and legal interpretations of the ideological objectives of an Islamic economy, and the nature and functions of the state in an Islamic society (Shahriari-Rad, 2002). Economic manifestations of this crisis have been reflected in the insecurity of private capital and property rights, with detrimental effects on the process of production in general, causing hyperinflation, shortages of basic commodities and stagnation of the economy. This situation has been further aggravated by the accumulation of foreign debt, a substantial increase in 'rent-seeking' activities at the expense of productive enterprise, a shrinking of capital stock, an inadequately trained workforce and a lack of reform in economic institutions (Khavand, 1999).

The direction of the Iranian economy is still influenced by religious debates. More specifically, the privatisation policy is the result of negotiation between economic development, social justice and cultural identity. In all four periods, Iran's rulers have largely failed to overcome the conflicting demands of economic growth, social justice and a conservative, Islamic cultural environment. The Shah embraced economic growth at the expense of other objectives, alienating almost the entire population in the process (Personal Communication).<sup>93</sup> The various leaders of the Islamic Revolution have, at different times, promoted economic growth and social justice in the context of an

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<sup>93</sup> Personal Communication. Discussion with Mr Hossein Nasiri, former Adviser to President Khatami, Tehran, July 2004.

Islamic government, but have been stymied by conflicts within governing coalitions over the appropriate balance between the two aims and their conformity with Islamic doctrine.

Certainly, Iran is not alone in confronting these kinds of tensions. Other societies, not least those of the West, face similar challenges, and at different times have attempted a variety of political strategies to overcome them. Generally, where societies have been perceived to succeed in this regard, it is by promoting one or possibly two objectives at the expense of the other(s).

This must lead one to pose the question: are economic growth, social justice and the maintenance of the cultural status quo an 'impossible triple'? Rahnema and Behdad (1995) argue that the attempt to implement Islam as a political philosophy is bound to disappoint because it promises to achieve all three objectives, despite the fact that laissez-faire economics (presumably conducive to growth) and social justice are in fact inimical:

While Islam promises social justice to the poor and destitute, it also makes it clear that the quest for worldly possessions, the accumulation of property and profit, is not only accepted but highly respected. ...The Islamic revivalist movements promise the establishment of a social order that will unite conflicting aims: the welfare of the poor and the security of property (Rahnema and Behdad, 1995:12).

The authors go on to argue that, under the conservative–pragmatist coalition associated with Rafsanjani and Khamenei, social justice was downplayed in an attempt to attain cultural and economic imperatives. Khomeini's Abu Dharrian rhetoric, to liberate the *mostazafin* (oppressed) from the *mostakberin* ('fat cats'), has been dropped.<sup>94</sup>

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<sup>94</sup> Abu Dharr was a companion of Mohammed associated with defending the cause of the *mostazafin*. He was exiled by the third Caliph for his excessive radicalism. His version of Islam is associated with radical interpretations of the religion, arguing for social justice, land reform and the like - see Rahnema and Behdad (1995:12).

Abrahamian concurs, arguing that Rafsanjani and Khamenei, since Khomeini's death, have continued denouncing imperialism, Zionism and 'exploitative capitalism' while, at the same time, protecting petty-bourgeois property and further toning down their radical rhetoric. They no longer talk of land reform, income redistribution or nationalisation of foreign trade (Abrahamian, 1991:119).

The Khatami era, which has seen a more liberal approach to social policy resulting from a rapprochement between the radicals (leftists) and the moderates, now seems something of an aberration. As Wells argues:

It is clearly the revisionist right that has the upper hand; so long as they control the courts and the faqihship, hard-liners and moderate reformers will be on the defensive. ... Thermidor may be slowly and painfully coming to a close with Islamic Iran exiting its era of leftist supremacy only to embark on a new phase of revisionist right-wing domination (Wells, 1999:39).

This view was confirmed by the victory of the conservative candidates in the 2004 elections to the *Majlis*.

If the Islamic Republic has largely failed to master the contradiction between development, equity and cultural imperatives, it has, to an extent, allowed Iran to move away from the wholly 'arbitrary state' identified by Katouzian (2000; 2003) as the norm for Iranian political institutions. Whether this is a long-term development is open to question, as Khatami's project of 'Islamic democracy', based on strengthened civil institutions, appears to be one of the main casualties of the conservatives' recent revival.<sup>95</sup>

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<sup>95</sup> Other observers tend to be more optimistic about the future of reform in Iran: "The ebbing of political Islam is bringing about a detachment from religion. The fact that the revolution took place means that the flow can run only in the direction of secularization..." (Roy, 1994:181).

Iran witnessed a further intensification of the Republic's chronic factionalism. Recent sabre-rattling over the country's nuclear facilities – in open defiance of the 'Great Satan' (the US) and other Western powers – suggests that the clerical establishment may also be engineering a return to Khomeini's policy, or raising the spectre of foreign intervention and domination to mobilise support internally. The anti-Western discourse, which previous Iranian leaders have used in the past, does not seem to help the Iranian economy. Khatami realised this and tried to promote an openness to foreigners. An example of this policy is reflected in the government's rapid acceptance of foreign aid after 2004's earthquake in Bam, which stood in contrast to the rejection of similar offers that followed Iran's last big quake, in 1990. The Council of Guardians has even been persuaded to ratify legislation designed to attract foreign investment (Anon, 2004b). 'Revisionist' or conservative domination is unlikely to derail Khatami's economic reform programme, mainly because the conservative coalition is at least as committed to privatisation and (economic) liberalisation as was the broad leftist coalition associated with the President. During the 2004 election campaign, conservatives stressed the need to eliminate factional struggles and concentrate on economic reform to attract inwards investment (Muir, 2004). The incumbent President seems in favour of encouraging foreign and domestic investment, but still keeps a cautious or rather nationalistic tone when emphasising the role of Iranians living abroad rather than of totally alien or Western companies. In his words:

One of the main topics of our economic policy is the expansion of foreign and domestic investment... We will especially use our dear Iranians [currently living abroad] who are ready to take part in developing their country... (BBC, 2005d).

Whether this will be attainable, given Iran's recent history of chronic political factionalism, the continuing friction between state power and wider society, and the tension caused by Iran's strained foreign relations, is more open to question.

#### 4.4.2 *Economic Development*

The Iranian economy is in rather a bad shape. Iran's population has doubled since the revolution, dramatically increasing consumption. With no growth in the output of the economy (GDP), the standard of living has halved. Half the population, including 70% of government employees, live below the official poverty line. Many have more than one job just to make ends meet. Unemployment is estimated to be 25%, and the future seems bleak. Every year 800,000 young people enter the job market. It is estimated that more than \$100 billion needs to be invested to maintain current employment levels, but only \$2.3 billion is currently allocated to job creation (Reuters, 1998a).

After 1989, the critical division was on economic policy, between the radicals (*Maktabis*) who clung on to Khomeini's early populism, and the conservatives whose economic views reflected the laissez-faire approach of their *bazari* constituency. The balance of power between the two factions ebbed and flowed, whilst prominent power brokers – notably President Rafsanjani and spiritual leader Khamenei – attempted to implement a pragmatic reformist agenda with little success. As Owen argues, the chronic factionalism of the period (1989–97) resulted in “a stand-off between the two main factions in which few new policy initiatives were possible at the national level” (2000:112).

The conservatives' improved showing in the 1992 *Majlis* elections, which left them in control of most of the institutions of state and with an ally (on economic matters particularly) in President Rafsanjani, should have cleared the way for economic reform. However, the right was hamstrung by its “reluctance to compromise on a number of critical issues, most of which revolved around foreign and cultural policy” (Wells, 1999:33). Having attained power, the conservatives undermined their coalition by weeding out socially liberal clerics and technocrats. This inability to forge a consistent position on economic development and cultural/political issues then undermined the conservatives' ability to implement their economic reform agenda.

President Khatami has been fully committed to restructuring the economy. His government approved the privatisation of 538 state-owned companies through auctions and stock sales, with plans to privatise another 2,000 (Reuters, 1999). The Iranian parliament (*Majlis*) approved plans to overhaul the oil industry and boost Iran's sagging oil production from 3.5 million bpd (barrels per day) to 6 million bpd over the next ten years (USEIA, 1998). This will require at least \$120 billion in capital, which has to come from private investors and foreign sources.

One major factor affecting the development of the Iranian economy is the effect of subsidies. These subsidies amount to more than \$7 billion a year for foodstuffs and, in particular, gasoline. They have led to chronic budgetary problems for the Iranian government.

In 1998, fuel subsidies alone reached \$11 billion per year – double the country's development budget. Food subsidies on basic commodities such as bread, rice and sugar account for another \$2.2 billion per year. Together, these subsidies use up virtually all of the country's \$16 billion oil income for the year (Reuters, 1998b). President Khatami has come to accept market reform and, with no other source of capital available to the country, advocates attracting foreign investments. The President has skilfully combined cuts to subsidies, the privatisation of state firms and changes to labour laws (in short, 'shock therapy' to the market), with calls for the liberalisation of social and political rules to allow freedom of expression, freedom of the press and the establishment of a 'civil society'. Most recently, the unbearable costs of subsidies for public finances has forced parliament to present a draft law that aims to cut down on the amount of subsidised petrol that motorists can consume. One should mention that what is beneficial for the economy may not necessarily bring with it support from the population. This last measure, if implemented, will certainly go against Ahmadinejad's electoral campaign promises and therefore against his popularity (Coville, 2005).



#### **4.4.3 *The Evolution of Economic Policy***

Briefly, the evolution of the Iranian economy since 1989 has been one of economic reform of varying degrees of intensity. Broadly speaking, there are two major ways that this has been occurring. The first has been to attempt to diversify the Iranian oil-reliant economy into others areas. An example is the growth in the investment of oil revenues into the petrochemical industry (PIIC, 2000).

Through a strategic development plan and the implementation of various petrochemical projects, efforts are underway to raise the production level of Iran's petrochemical industry. Begun in 1997, the plan is divided into five phases, lasting until 2013. By the end of this period, the total volume of final products is estimated to be 16.8 million metric tons per year. The value of investment will amount to \$20.6 billion, with total sales topping \$11.8 billion per annum (Ibid.).

The services sector has seen the greatest long-term growth in terms of its share of GDP, but currency exchange restrictions, excessive bureaucracy and the uncertainty of long-term planning have made this a volatile sector. State investment has boosted agriculture, however, with the liberalisation of production and the improvement of packaging and marketing helping to develop new export markets. Large-scale irrigation schemes, together with the wider production of export-based agricultural items such as dates, flowers and pistachios, have produced the fastest economic growth of any sector in Iran over much of the 1990s, although successive years of severe drought in 1999, 2000 and 2001 have held back output growth substantially. Agriculture remains one of the largest employers, accounting for 22% of all jobs according to the 1991 census (Economist Intelligence Unit, 2004).

The other method of economic reform is the attempt to attract foreign investors into the Iranian economy by creating a more favourable investor climate. The methods of doing this include reducing restrictions and duties on imports or creating free trade zones.

#### **4.4.4 *The Financial Sector***

The financial sector in Iran was transformed following the 1979 Islamic Revolution, with the nationalisation of all banks and re-vamping of the financial sector based on Islamic financial principles upheld by the Law on Usury-Free Banking of 1983. In recent years, the government has implemented reforms in the Iranian financial sector aimed at bringing it closer to international standards. However, the sector remains characterised by heavy government intervention (*Iran Daily*, 2004).

The banking sector in Iran is run according to Islamic law, which prohibits interest payments. Only since 2001 have private banks been authorised to operate and foreign banks been given permission to operate in Iran's free trade zones. Currently, the banking system consists of six state-owned commercial banks, four state-owned specialised banks, a state-owned postal-operated bank (licensed in 2004) and four recently established small private banks.<sup>96</sup> State-owned commercial and specialised banks dominate the banking system, holding about 98% of deposits. Iran's financial system also includes a number of small banking institutions and informal financial intermediaries. About 6,000 'Qarz-ul-Hasanah' funds, which raise zero interest funds and provide interest-free loans, operate on a small scale. The sector is supervised by the Bank Markazi, the central bank. The World Bank and the IMF have been providing assistance in enhancing banking supervision to the Bank Markaz.

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<sup>96</sup> June 2004 pronouncement of Article 44 of the Constitutional Law.

Iran's insurance sector is still dominated by the state. However, the sector has also been on the path to reform and liberalisation. Following the revolution, all insurance companies were nationalised and the sector still remains under state control, with approximately 50% of policies issued for compulsory third-part liability car insurance (Dana, 2004). Recent reforms include the allowance of private insurance companies in the free trade zones. There are currently five major state-owned companies, five private domestic companies and the first foreign representative office was opened by a UK firm in Tehran in 2004. The Central Insurance Authority (Bimeh Markazi) is the regulator and provides re-insurance.

The Tehran Stock Exchange (TSE) reopened in 1989 and has performed well in recent years, with over 300 listed companies, the majority of which are parastatal enterprises with a varying degree of direct and indirect government ownership. The TSE has also started a modernisation programme and has opened regional branches in other cities in Iran. There is no independent supervisory entity that oversees issuance and the trading of securities (First Initiative, 2005).

Mr. Ahmadinejad had denounced Tehran's Stock Exchange, equating it with gambling. Although his position quickly changed once he took office, the market nonetheless took a serious blow. According to a survey by Karafarin Bank,<sup>97</sup> Tehran's Stock Exchange reached its lowest point nine months into Ahmadinejad's presidency. The index registered a 26% decrease compared to its peak at the end of the first month of the year. The drop affected financial stocks by 44% and industrial stocks by 20%.

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<sup>97</sup> Personal Communication. Discussion with Dr P. Aghili, Managing Director of Karafarin Bank, Tehran, December 2006.

#### 4.4.5 Oil

Oil continues to play an extremely important role in the Iranian economy. Iran is still the second largest oil producer in OPEC (Organisation of the Petroleum Exporting Countries). It holds 10% of the world's proven oil reserves. In addition, what may become even more important in the future is that Iran holds the world's second largest natural gas reserves (the largest belonging to Russia) (Personal Communication).<sup>98</sup> Clearly, such large oil reserves dominate the Iranian economy.

An additional complication is that Iran's international economic situation is highly dependent on the price of oil. In fact, it is possible to trace the Iranian internal economic situation based on the changes in the world's oil prices. For instance, the strong oil market in 1996 led to increased government revenue for Iran which eased financial pressures on the country and allowed for timely debt re-payments by Tehran. Then in 1997, the lowering of world oil prices led to a tightening of the Iranian financial situation. Then, again, in 1999/2000 the rise in world oil prices afforded the Iranian government an increase in funds. Such booms and busts in the world oil market can be traced up until this present day and should continue to have some effect on the Iranian internal political situation.

In particular, we may predict that rising oil prices will have a dampening effect, *ceteris paribus*, on the drive for economic reform in Iran (Personal Communication).<sup>99</sup> The reasoning is that with higher oil prices the government has more money in its budget to pay the previously discussed subsidies in the Iranian economy. These subsidies provide incentive in Iranian society to continue a status quo political situation – including an economy based on oil and subsidies. Thus, it is a self-reinforcing cycle.

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<sup>98</sup> Personal Communication. Discussion with Dr Mohammad R. Arasti, Assistant Professor, Sharif University of Technology, Tehran, December 2005.

<sup>99</sup> Personal Communication. Discussion with Engr. Mohamed Hossein Nejad Hosseinian, Deputy Minister of Petroleum, International Affairs, Tehran, December 2005.

It is when the oil price drops that we may expect, again *ceteris paribus*, more calls for reform in the economy. The logic is similar. With a lower oil price, the government is left with less money to bring to the internal economy in the form of subsidisation. This in turn can translate to unpopularity within society. Unpopularity can lead to calls for reform in different ways. Again, a self-reinforcing cycle is formed. Thus, we see here the sort of political-economic interactions that will help to determine change in the Iranian economy.

Investment is badly needed in the oil industry as it produces benefit for the entire economy. A recent IMF report on the Iranian economy predicted that Iran needs to mobilise \$4 billion a year in foreign loans and direct investment if it is to achieve a level of growth which stabilises unemployment, that is 5.4% on average (IMF, 2003:34). The report assumes that Iran will secure significant foreign investment in the oil industry and that Iran will borrow \$3 billion a year. If Iran did not have access to that kind of foreign capital, it would suffer directly from the \$4 billion a year shortfall and it would suffer further from the loss of the expanded oil exports that those funds would finance. In particular, the IMF forecasts that foreign funds will allow Iran to expand its oil exports from 2.3 million bpd in 2002/03 to 3.9 million in 2008/09. However, if oil exports stagnate at the 2002/03 level, Iran would have \$11 billion a year less by 2008/09. In other words, foreign funds and the expansion in oil exports they make possible are central to Iran's economic plans - and could be key to preventing social unrest (Clawson, 2003; IMF, 2003:34).

The country has failed to properly maintain its oil fields since the revolution, and particularly after the severe damage sustained during the Iran-Iraq war. As a result, the recovery factor in Iran's oil fields has declined to a range considerably below that of international norms. Yet while some oil deposits might have been permanently lost as a result of poor maintenance, oil well capacity has not been irretrievably damaged and the ongoing gas injection programme has significantly raised the recovery factor (Amuzegar, 2007). Accordingly, official data show that since the end of the Iran-Iraq

war in 1989, Iran has actually added more oil to its reserves than it has taken out of the ground.<sup>100</sup> In addition, due to some one million b/d condensates from the South Pars gas fields being added to the daily output, the *Middle East Economic Survey* (MEES) estimates show an actual rise in Iran's domestic production in recent years (Amuzegar, 2007).

In short, based on official<sup>101</sup> and generally accepted reserves figures, at the current rate of extraction, Iran will be able to produce and export oil for the next 70 years.

#### 4.5 Conclusions

This chapter has focused on the more recent post-revolution era (after the death of Ayatollah Khomeini in 1989). During the immediate post-Khomeini period (1989–97), leadership passed to more pragmatic and reformist figures such as Ayatollah Ali Khamenei (who took on Khomeini's role as spiritual leader or *faqih*) and Ali Hashemi, Rafsanjani (who was elected as Iran's first executive President). Theorists have identified the Rafsanjani era as the beginning of the 'Thermidor' (a reaction against the early idealism of a revolution) in the Islamic Republic, when Khomeini's radicalism was replaced by a greater willingness to compromise, particularly in the field of economic policy. During the post-1997 period, a more politically liberal climate has emerged under the presidency of the moderate cleric Khatami. Most conclude that the President, re-elected in 2001, has largely failed to overcome the opposition of powerful conservative elements within the clerical establishment.

Political factionalism and the inherent contradiction between an Islamic Republic and economically liberal tendencies have marked the decision-making process. One of the

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<sup>100</sup> Personal Communication. Discussion with Engr. Mohamed Hossein Nejad Hosseinian, Deputy Minister of Petroleum, International Affairs, January 2007.

<sup>101</sup> Ibid.

elements of novelty within the Iranian political scene after 1989 has been the separation of the institution of the supreme leader and that of the President of the Republic. Although the *faqih* still preserves considerable influence, having the power to intervene on any issue, including specific pieces of legislation, the final outcome of a policy is more about bargaining (as in the case of political bureaucracies in secular and democratic states) rather than outright imposition of the former's views. Political and religious leader are important, but their will does not necessarily translate into action.

Since 1989, the population has boldly risked the wrath of the Revolutionary Guards by erecting camouflaged satellite dishes in order to tune into the news of the world. Furthermore, the use of computers and the Internet has swept across the society, which in turn has helped the masses to be more aware of both regional and international politics.

A more obvious tendency in the period analysed in this chapter has been the polarisation of politics around conservative and reformist camps. However, one must say that this separation refers only to economic issues. An additional factor is the social one. This is a reflection of a need to reconcile the conflicting demands posed by economic growth, social justice and the Islamic cultural environment.

The Iranian foreign policy and the discourse towards the West have consolidated the image of a potentially aggressive state together with accusations of supporting international terrorism. The Gulf War, Iran's relations with the Hezbollah, the recent Iraq war and controversies over the Iranian nuclear programme have impeded an environment of trust between Iran and Western actors. However, the post-1989 Presidents have been more opened to market-oriented reforms and have pursued privatisation policies and openness to foreign investments. The dependency on oil prices and increased subsidies and lack of extensive investment in other sectors have remained the major stalemates in the country's economic development. There are, however, economic measures (e.g. in the financial, oil and gas industry sectors) that signal Iran's

willingness to adopt liberal policies. The questions regarding the degree and deepness of reforms, as well as about the options available, will be addressed further in the next two chapters.



## **CHAPTER 5: PRIVATISATION IN IRAN**

### **5.1 Introduction**

So far, this study has detailed the theoretical and historical background to Iranian oil and gas privatisation. This chapter will address the privatisation of Iranian oil and gas head on.

We are now in a position to directly address the specific determinants of Iranian privatisation policy. This chapter focuses on the four primary factors which directly affect privatisation policy. These are the specific background of privatisation thought in Iran; the legal and institutional framework; the nature of oil and gas relative to privatisation in Iran; and the personal thoughts of relevant policy-makers.

The first factor to be addressed is the specific background of privatisation in Iran. This section will build on the earlier historical, political economy sections. The concepts it explores will be taken for granted, based on the background of the earlier historical and theoretical chapters.

The second point is the legal and institutional framework. This section will be based on a reading of the relevant legal documents concerning privatisation post-1990 in Iran. It will also explore the institutional issues which have arisen since that time and which constrain policy decisions.

The third point is that the oil and gas sector is unique in Iran and needs to be addressed separately from different types of privatisation. This section will directly address the contemporary determinants of Iranian oil and gas privatisation. It will be based on the political economic issues concerning oil and gas in Iran covered earlier. It will also bring into play supplementary information towards understanding this sector. Together

this will provide us with a specific understanding of oil and gas sector privatisation in Iran.

Finally, this chapter presents primary research on the personal views of relevant decision-makers in Iran who are concerned with privatisation. This is based on extensive interviewing with relevant sources. The interview questions are explored in order to provide a perspective on what kind of information is relevant and what sort of biases can be expected. The results of the interviews are then described and examined.

## 5.2 Background

In order to consider the extent to which privatisation relates to economic development, the latter concept needs to be considered in the particular context of the country in focus. In the case of the Islamic Republic of Iran, religious cannons and cultural values are obviously a factor to be considered on a par with the specific political and social context. Modernisation and growth, including the insertion of the national economy into the dominant Western models of organisation and management which are based on private ownership and state *laissez-faire* policies, need to be considered alongside the firmly established social traditions and beliefs (Shahriari-Rad, 2002).<sup>102</sup> The *Qu'ran* itself recognises that growth and change should come naturally, as they do through the cycles of human life. Hence, the necessity for combining 'effective' with 'appropriate' economic policies and development strategies (Poku and Pentiford, 1998).

With respect to this, no privatisation plan should dare to go against or challenge the legacy of the past and the embedded cultures and values in society, else it risks having to be implemented in an overtly hostile environment. Being a critical mechanism for change, privatisation needs to serve legitimate social purpose and meet pressing human

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<sup>102</sup> The introduction to the following section is based upon the work of Shahriari-Rad (2002).

needs. This way, it is less likely to give rise to populist political discourses that would ridicule, or even cancel, its achievements. In addition, it must take into account what is tolerable within the given society and how far ownership transferral can go before generating a debilitating backlash. Privatisation policies thus need to be carefully crafted with a view to ensure their proper implementation, by bringing on board as many influential constituents as possible.

At present, Iran seems to be committed to some level of privatisation, both in terms of practical activities and political discourse. Domestically, this is a subject of diverging interpretations stemming from conflicting readings of Islam and its economic doctrine. The latter range from more conservative approaches to capitalism, treating with suspicion the accumulation of wealth and wishing to limit its permissible level and usage, to more liberal stands, calling for some degree of synthesis between Islamic principles and theories of modernity (Zubaida, 1993). They have defined the framework within which related economic policies have been initiated, formulated and implemented and have given guidelines for the latter's interpretation and assessment, particularly with the lack of immediate and visible short-term effects.

Despite divergences, a consensus has emerged that the economies which have taken on board the principles of Islam are neither purely capitalist, nor avowedly socialist. Instead, they are represented as following a 'third path' of economic management by the state, one where both the material and the spiritual needs of people and communities are taken into account in constructing a reliable frame of reference for assessing the viability of its policies (Amuzar, 1997). Under this ideology, private property is not recognised as absolute; it is subject to the limitations defined by Shari'a rules, which postulate its legitimate acquisition and socially responsible usage. Since the ultimate owner is God, the holders of property rights are accountable to him for how they

exercise them. The state is a necessary arbiter in this relationship. In this sense, the Iranian economy is a particular mixture of private and public property rights.<sup>103</sup>

Capitalism is rejected on the grounds that it produces great disparities of income and property distribution. Its emphasis on individual self-interest and the strive for profit in business is seen as reducing solidarity within communities and depriving societies of their humane character, the sense of brotherhood and the need for cooperation. The almost absolute respect for property rights, individual ownership and free enterprise result in antagonistic and competitive practices that are detrimental to the socially just distribution of resources and industrial and public goods. Seen from the viewpoint of Islamic political economy, capitalism is an inherently contradictory economic philosophy within which greater production and consistent growth do not necessarily translate into higher levels of welfare for greater numbers of people (Sadr, 1989; Abrahamian, 1993).

Similarly, socialism is rejected on the grounds that it limits the chances of personal development by curtailing freedom and choice, and determining a dominant economic role for the state and its government. Moreover, class struggle is considered to be inimical to the Islamic way of life, where harmonious society is the result of all individuals working together for the good of the whole society. The corruption inevitably accompanying ubiquitous economic ownership and management by the state has also been criticised, as is the employment of surplus resources for financing the internal security apparatus and the repression of dissenting opinions. Taking on board some positive aspects, such as central planning, the popular welfare system and the reduction of unemployment, Islamic scholars have redefined their desirability and positive societal effect with exclusive reference to the Shari'a (Mannan, 1989).

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<sup>103</sup> As such, it is based neither on the unlimited freedom of private ownership typical of capitalism, nor on the public ownership that denies private property rights (Taleghani, 1983).

Historically, the presence of influences from the two largely opposite positions (capitalism and socialism) in Islamic economic thought has resulted in conflicting strategies of economic management undertaken by the Iranian state since the Second World War. For decades, at the beginning of the twentieth century, Iran's economy remained disintegrated, largely owing to the control exerted by the Anglo-Iranian Oil Company over the oil industry. It thus remained an independent economic enclave with no 'forward' or 'backward' linkages to the rest of the economic life in the country (Nazmi, 1989:33-54). The private sector was small and insignificant, while the state did not command sufficient resources in order to build a strong base of state-owned industrial enterprises that would generate economic growth and secure re-investment funding.

With this objective in mind, but also guided by the desire to remedy an historical injustice, the National Front majority in the Iranian parliament passed a nationalisation law in 1951 (Personal Communication).<sup>104</sup> Under it, all of the oil industry that was practically developed in the preceding decades by the Anglo-Iranian Oil Company entered the portfolio of the state. The latter thus acquired full property rights, including control rights (through appointing management teams), exploitation rights and the right to the profits from the sale of oil, which were earlier channelled back to England. Oil export sanctions were the logical answer of the British government, which generated a domestic policy of import substitution. This helped the national bourgeoisie flourish and resulted in an increased domestic production and modest industrial development. Some of it was financed by the state itself, which raised revenues by selling its gold reserves held in Canada and South Africa.

In the early 1950s, there was a brief involvement of the World Bank in the Iranian economy, with a proposal for settling the dispute between Iran and England by distributing the revenues from oil between the two states. The National Front leader,

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<sup>104</sup> Personal Communication. Discussions with Mr. Houshang Naderian, Chairman & Managing Director, Audit Organization, Tehran, December 2005.

Mossadegh, who was then the Prime Minister of the country, refused the plan as it offered a price for Iranian oil significantly lower than the current market price. Adding the US's reluctance to respond positively to Mossadegh's request for additional aid in times of heightened inflation, resulted in the visibly bad shape of the Iranian economy due to the lack of badly needed rehabilitation cash. In these conditions a conflict arose between Mossadegh, supporting and supported by the bazaars and the national bourgeoisie, and the Shah, supported by the landed gentry. At this point in time the religious community was divided in its allegiances, being the largest landowner in Iran while supporting the nationalisation of the oil industry.

When oil production and export resumed, the economy quickly picked up speed. Between 1953 and 1978, under the Shah's rule, the Iranian economy grew at a rate matched by only a few other countries. Nazmi quotes the 1960s as a relevant example, during which time the real GNP increased at an annual rate of 7.5%, and also the years between 1965 and 1973 when the real GDP increased by an annual average of 10.4% (Nazmi, 1989:40). This process of economic growth, although beneficial in terms of social development (reduced infant mortality rate, increased life expectancy, etc.), brought about conditions for overall underdevelopment in Iran. The main reason for this was the over-reliance on economic rent from natural resources, which had shaped class relations and determined a structure of incentives for economic agents that led them into passive co-existence alongside the national oil industry.

In such conditions, privatisation took the form of the state-led development of a rudimentary private sector within a mixed property rights regime (Personal Communication).<sup>105</sup> Before the revolution, the emerging entrepreneurial class in Iran relied exclusively and unequivocally on resources supplied to it by the state apparatus. The state thus, instead of being an impartial regulator of a vibrant private sector, became its most important and influential sponsor and, by implication, its unwitting controller.

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<sup>105</sup> Personal Communication. Discussion with Dr. Manouchelir Lighrani, M.D., former landowner, Tehran, December 2004.

This was largely enabled by the independence of foreign capital offered due to the possibility to receive and manage the revenues from oil sales. The state could afford to help the national entrepreneurial class not only by direct financial means, but also by passing legislation that protected it from foreign competition, by granting tax cuts and subsidies.

According to Nazmi (1989), the private capitalist class in Iran was thus not an indigenously created bourgeoisie, i.e. generated by entrepreneurial economic actors wishing to (re) invest the surplus from directly productive industries in the same or other sectors. It was created because the demand structure for the chief natural resource of the country (oil) was such that the state could collect a considerable amount in economic rent and artificially finance an investing class. Hence, the orientation of this class towards the state as a guardian and mentor. It was not born out of the development of internal relations of production and could not be an independent economic force in and of itself. In this way, the private sector in Iran was doomed to be composed of people who, often with relatively little capital of their own, acted as agents of the state empowered to use public funds.

In the 1960s, enabled by the state's command over large financial resources, and aiming to stir up this emerging entrepreneurial class, the Shah started to openly pursue modernising economic and social policies. Industrialisation was supported by the West. The Iranian economy thus became a workable system from a Western point of view which, even if experiencing certain problems, was able to adjust and survive in the face of the economic challenges of a globalised world (Rubin, 1981). It has to be acknowledged that the Pahlavi dynasty managed to generate huge cashflows and attract foreign investors into Iran. The Shah created opportunities for economic modernisation and development by rapidly expanding the basic infrastructure of the country. However, as Shahriari-Rad (2002) argues, these efforts proved unsustainable and cut across both the socio-cultural and economic capacities of the country to absorb change.

It was this discrepancy that gave strength to a rising discontent, fuelled by the religious clergy and supported by the bazaars. The Islamic Revolution of the late 1970s emphasised traditionalism in economic development, social justice and sovereignty. It was aimed against foreign influence in the Iranian economy and society and all national actors who promoted it (Khalili and Manafi, 2000). In a way, the revolutionary mood in the country became self-reinforcing. The rapid economic change and undue foreign presence generated an open opposition. Once it became an evidently potent social force, it caused a sense of insecurity that resulted in insiders asset stripping banks and private enterprises. This in turn made the revolution an even more pressing need and gave it additional and favourable arguments and justification. In the years following the revolution, the private sector was largely stifled and economic initiatives returned to the state sector through the five-year plan.

At present, having lived through more than two decades of Islamic revolutionary rule, Iranian society and body politic seems to be decisively turning towards the modernisation paradigm again. An important part of this is privatisation and the drawing in of foreign investors with technological resources and know-how. The latter is particularly relevant if productivity in the oil and gas fields is to increase. In the government's third economic plan, privatisation occupies a central place. It is recognised to offer the possibility of reversing the economic problems inherited from the past and to open the existent, but obviously neglected, potential for growth and development. It has been argued that, at present, there appears to be a very little choice on the part of the Iranian government but to privatise. Rather, the important choice concern the modalities of implementing the Iranian privatisation policy and the industries which it will eventually cover (Shahriari-Rad, 2002).

There are a number of pronouncements and reports supporting such a line of argumentation. The Deputy Energy Minister, Reza Amrollahi, recently issued a statement to the effect that the Energy Ministry is acting more rapidly than other ministries to cede its affiliated companies to the private sector: "we have prepared



almost all subsidiary companies of the Energy Ministry for cession to the private sector and our speed is unparalleled by other state bodies” (PIN, 2004). It seems, however, that the promise for reform backlashed in the last parliamentary elections of February 2004, at which the reformist followers of President Khatami lost their majority to conservative hardliners. Since taking office in 1997, Khatami has sponsored efforts to modernise the economy in a number of ways, including privatisation, but the lack of visible progress has revealed an incapacity to win over antagonistic political and social forces.

### **5.2.1 *Analysis of Background to Privatisation in Iran***

The relevant question for analysis then becomes, ‘what does this return to an attitude of modernisation hold for the future of privatisation in Iran?’ To put the question in a different form, ‘how and to what degree is this a factor in the decision-maker’s mind with regard to the future of the privatisation of the oil and gas industry in Iran?’

This question may be impossible to answer, however, since it is predicated on an understanding of how the context, or structure, of the decision-making system affects the actual decisions of actors. In other words, we have to ask such theoretical questions as to the degree in which history and attitudes matter in decision-making in the present. There is a related question about the degree to which the system itself will determine the nature of decisions in and by the state. For instance, ‘to what degree does the competitive struggle of Iran in the international system determine the decisions which policy-makers will reach in Iran?’ Or, looking at it another way, ‘to what degree do internal political, demographic, or other changes in a state determine these decisions?’ Finally, one could take the perspective that the nature of the capitalist market system will simply determine the nature of the policy choices which are made, because otherwise the state and its economy will simply go bankrupt.

These questions are clearly far beyond the scope of this thesis, although there has been an attempt to partially address them throughout the text. For instance, Giddens' concept of structuration was used to explain the interplay of structure and agent in determining the theoretical and precedent-based boundaries and constraints in the possibility of privatisation in Iran, or for that matter, any state. Yet, even the use of this concept does not provide conclusive answers to the questions posed in the previous paragraph.

In fact, this thesis is not really looking to answer this kind of broad question. Throughout the text, it has gradually narrowed down its scope to only asking what the determinants of the policy of oil and gas privatisation are in Iran. In doing this, we assume that the historical and background factors discussed are in fact important issues to be taken into account. However, at the same time, they may not necessarily be the only, or even the primary, cause of a particular policy. It also means that we can assume that the final decision of the policy-makers might be constrained by structural issues within the economic, internal political or international military-political system in the long run. Nevertheless, in the short term, subjective determinants (such as the minds and views of the policy-makers) will come into play and influence the decisions made.

This is simply a convoluted way of saying that this thesis will not consider a considerable portion of the existing theoretical literature in reaching its conclusions. Theory is nevertheless an important tangent that situates this study within the theoretical constraints of social science theory in general. Without doing this, we would be assuming a level of potential knowledge about the subject and proof of findings that is impossible given the constraints of the epistemological realities of the field in general. Although these issues are often simply assumed in many theses which have the same scope of this one, they should not be. This might result in the readership being falsely convinced, or even worse, it might trivialise the real findings that this thesis provides.

Thus, given this qualification, we should conclude that the factors noted in the previous section and predicated by the political economic analysis of history performed in

Chapters 2, 3 and 4 (between 1945 and contemporary Iran) are in fact worthy of consideration. Moreover, the reversion to modernisation as an underlying concept which will determine Iranian privatisation policy is equally important. The reversion to a causal view of modernity is likely to inform policy-makers' decisions and decision-making in Iran. At the same time, these insights must be brought into the context of other factors that have determined, and will continue to determine, the timing, nature and possibility of privatisation in Iran. These supplementary factors include the ones discussed in previous chapters. Specifically, these are the further historical factors, the boundaries of privatisation theory in general and the precedents set by other examples of privatisation taking place within the geographical region of Iran, and in other regions which have similar industries and/or natural resources.

There are three more factors to be discussed in this chapter. The first is the nature of the legal and regulatory system in Iran. The second refers to the particular constraints of the oil and gas industry versus other industries, such as telecommunications. The final factor concerns the current, subjective, political, social, cultural and other views of the decision-makers relevant to privatisation policy-making in Iran. For each of these factors, the same epistemological issues noted above hold, and the same answers to those epistemological issues should be assumed.

However, before moving on, there is another matter that needs to be briefly mentioned. This is the acknowledgement of unpredictability in national politics. In particular, the recent election of Ahmadinejad was taken by some analysts as being unexpected (Pollack, 2006). Also, more importantly for this discussion, the particular policies and policy paths that he has chosen, and will choose, do not necessarily align with the points made above – i.e. that there has been a reversion to the pursuit of modernity, and that modernity is causal for privatisation policy in Iran. This issue will be covered in more detail in the concluding chapter of this study, but needs to be kept in mind given the conclusions and implications of this chapter, the discussion of this section in particular

and the thesis as a whole. With this in mind, it is possible to move on to discuss the other three factors affecting privatisation in Iran.

### **5.3 Legal and Institutional Framework**

Whilst privatisation in Iran (Privatisation Organisation, 2002)<sup>106</sup> may have been initially considered in the early 1990s,<sup>107</sup> the first concrete indication that a privatisation policy was gaining currency within the political, economic and, possibly, religious elite in the country was the law of the Third Socio-Economic and Cultural Plan of the Islamic Republic (Privatisation Organisation, 2002). It was adopted in 2000 and incorporated two chapters devoted to privatisation: a) Chapter Two – Reorganisation of State-Owned Enterprises and b) Chapter Three – Privatisation and Management of State-Owned Enterprises. Within a couple of years of its adoption, it was completed with a number of by-laws regulating the implementation of some of its articles and with the articles of incorporation of the Privatisation Organisation, which would become the main institutional embodiment of the privatisation policy. It has to be noted that such fragmented legislative framework is normal where state-ownership and control of the economy are pervasive. Privatisation Acts usually provide only the overarching elements of the policy, leaving the details of its implementation to sub-normative regulation.

Chapter Two of the Third Socio-Economic and Cultural Plan (Privatisation Organisation, 2002) authorises the government to take “all appropriate measures towards the divestiture, dissolving, merging and reorganising state owned enterprises”, including the “reforming and sanctioning of their article of association, and their transactional and financial by-laws” (Article 4). The stated purpose of these measures is

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<sup>106</sup> This section is based upon the compilation by the Privatisation Organisation (2002).

<sup>107</sup> Officially the Iranian privatisation programme began in 1995, when the origins, the reasons for popularity, requirements, management, social and economic consequences of privatisation policies, were relatively new to Iran and other countries in the Persian Gulf (Molawi, 2003).

to reorganise state-owned enterprises into specialised holding companies, managed under the auspices of resource ministries, and thus prepare the ground for the easy transfer of their shares into private hands. Chapter Two also provides for the separation of wider policy-making by the respective ministries and the day-to-day governance of the enterprises they control. The government is also required to dissolve all overseas branches of state-owned enterprises and to coordinate its restructuring activities with the State Administrative and Employment Affairs Organisation.

The need for the restructuring of state-owned companies is justified with the broadly stated need to “effectively utilise their resources and potentials” (Article 4). More concretely, Chapter Two contains two related objectives to “enhance the productivity and efficiency of those state-owned enterprises that will remain in the public sector” and to “facilitate transferring to the non-public sector the enterprises whose continued operation in the public sector is deemed unnecessary” (Article 4). The first category is guaranteed the privilege of utilising public capital, but only on the condition that the activities of those enterprises represent monopolies by their nature, or are of no investing interest to the non-governmental sector. Despite its reform-oriented tone, Chapter Two refrains from introducing price liberalisation (Article 5) which, in fact, could be essential for encouraging private entrepreneurial activity into the country.

Chapter Three of the 2000 Socio-Economic Plan (Privatisation Organisation, 2002) deals more specifically with the Iranian policy regarding privatisation. It mentions the need to “promote the role and scope of the private and cooperative sectors” in the economy and provides that “shares and stocks of the state-owned enterprises that are transferable shall be sold” (Article 9). Article 10 then sets the conditions and limitations with respect to the policy. According to Article 10, privatisation is to be considered only as a means for the realisation of the wider objectives of the Third Plan (Privatisation Organisation, 2002) and not as an end in itself. Furthermore, it must not jeopardise the national security or threaten the sovereignty of the Islamic Republic, nor should it infringe upon people’s rights, or create any monopoly. Privatisation is subject to the

Constitution with the condition that the policy should be implemented in the context of the latter. It is also required to promote the widest possible public participation.

Chapter Three enumerates the holders of shares, whose transfer into private ownership it regulates. Among them are governmental agencies and ministries, as well as profit-making entities affiliated with the government (Article 11). Article 11 also mentions the Iranian National Oil Company and the shares that it holds in non-public enterprises and companies. Control and supervision over the divestiture process is vested in the High Commission of Divestiture, which was set up under the chairmanship of the Minister of Economic Affairs and Finance (Article 12). Together with him/her, it comprises six other members (all high-ranking government officials): the Head of the Plan and Budget Organisation, the Governor of the Central Bank, the relevant minister (i.e. representing the ministry that owns the enterprise), the Minister of Justice, and one representative each from the Parliamentary Commissions of 'Economic Affairs, Finance and Cooperative' and 'Plan and Budget'.

The other relevant institution in the policy implementation process is the Privatisation Organisation. In fact, it inherited the previously existing Organisation for Promotion of Ownership of Production Unit through the change in the Articles of Association of the latter (Article 15). Since it is not the owner of any state company shares, the Privatisation Organisation receives them in trust from their holders, so that it can implement the transferral policy. The organisation is affiliated with the Ministry of Economic Affairs and Finance, possesses a legal subjectivity and is financially independent. Following the adoption of the Third Plan (Privatisation Organisation, 2002), its structure and responsibilities were further determined by the Articles of Incorporation adopted through a Council of Ministers Decree of 16 May 2001.

Article 16 outlined the criteria to be used in selling the shares of state-owned companies. According to it, the shares of small companies would be sold to (individual) "entrepreneurs of high managerial calibre". Medium-sized companies had to be sold to

specialised commercial groups, cooperatives and entities. By contrast, the shares of large companies were to be sold to the general public, while preserving a controlling share for the management. In preparing privatisation of state-owned companies, the High Commission of Divestiture was required to:

...determine the buyer's commitments towards employment, production programme, new investment, special activities to protect the environment, and avoidance of certain restrictive commercial activities (Article 17).

The implementation of Articles 16 and 17 was subsequently regulated through by-laws.

In terms of privatisation revenues, Chapter Three determines the following distribution. Fifty percent would be utilised to further finance the privatisation process, helping towards the restructuring of saleable companies and the rehabilitation and preparation of other state-owned enterprises earmarked for sale, as well as promoting industrial development with preference given to paying off the saleable companies' debts. Some 48% was designated to support the country's treasury. Finally, 2% was meant to support the Iranian mobilisation forces. It has to be noted that by 'privatisation revenues', Article 19 does not only envisage the sale of company shares, but all kinds of contracts (rental, leasing, etc.) that generate monetary income for the owner within the given fiscal period.

Chapter Three also provides for dispute settlement relating to claims made by physical or legal persons against decisions within Iran's privatisation policy. Interestingly, both parties to any given privatisation deal are obliged to insert a clause to this effect in the divestiture contract (Article 20). They are thus not granted any choice of dispute settlement body or procedure and are practically disallowed to refer to the general courts in the country; rather, they have to comply with the prescription of the Privatisation Act. This narrowing condition invites questions over the reasoning behind it. There is obviously a thrust towards laying the complete structure of privatisation

relations and creating what it seems are parallel institutions, such as the Arbitration Commission, that are required to take up functions generally performed by other state institutions.

For the purposes of the privatisation process, the Arbitration Commission consists of: a) five experts in economics, finance, commerce, technical and legal fields (jointly nominated by the Ministers of Economic Affairs and Finance, Justice, and the Head of the Plan and Budget Organisation and approved by the Cabinet for an appointment of six years); b) the Head of the Chamber of Cooperatives and c) the President of the Chamber of Commerce, Industry and Mines. Under Article 21, the Arbitration Commission is required to review and rule on all claims relating to divestiture. Its rules and procedures are to be formulated in a special by-law approved by the Cabinet. The minimum quorum for effective sessions of the Arbitration Commission is five of its members, while decisions are taken by a simple majority with on-the-record minority reports.

Once the Arbitration Commission has delivered judgement, it becomes binding ten days after the parties concerned have been notified. Within that period, any of them can raise objections to the decision and file it in writing. If an objection arises after the grace period, the parties can refer it to the Chief Justice of the country; having to prove, however, that there has been an objective reason for the delay. In such an eventuality, the Chief Justice needs to refer the case to a special tribunal, which will then review the claim extraordinarily and rule a judgement, which becomes final and binding for all parties (Article 23).

Following that, Article 24 requires the government to insure, at its own expense, all the officials who are individually or collectively involved in the privatisation process against possible penal consequences of financial conviction emanating from unintentional misconduct in connection with divestiture. It is required that the insurance policy obliges the insurer to compensate for whatever costs are to be borne by the



convicted official(s). This is again an interesting departure from modern legal tradition where costs may be covered for lawsuits, but not in cases of conviction. Questions arise as to why this is so in the Iranian privatisation code. One possible explanation was that this provision would alleviate the dislike towards engaging in a process that is potentially controversial and which could result in claims being made against personal decisions.

Finally, Chapter Three winds up with three articles relating to liabilities of the seller and the buyer for the company's debt or for potential losses during the process of concluding the divestiture deal (Article 25), to the tax implications of privatisation deals (Article 26) and to the social insurance of the employees (Article 27). Under Article 25, the divested company (i.e. its new owner) remains liable for all of its debt, which understandably should result in a discounted price, although this is not specified in the provision. Article 26 exempts all shares sold under the Privatisation Act, as well as shares transferred between executive agencies in enforcing the Act, from transaction tax. With regard to corporate income tax, this remains an obligation of the owner up to the end of the fiscal year prior to the sale, and this in fact transfers a bigger obligation onto the buyer, especially for companies purchased in the second half of a given year.

Concerning the social insurance of the employees of a privatised enterprise, Article 27 provides that those of them who are subject to the special pension funds affiliated to ministries or public agencies and whose employment with the divested company will be terminated upon its sale to the private or cooperative sectors may, upon reinstatement of their employment with the same company, continue to stay with the same pension fund. The provision is deceptively reassuring for employees, as it does not guarantee their work place, but only their participation in pension funds if they stay or resume employment with the company after its sale. Understandably, this would generate antagonism to privatisation within the worker's associations in any given enterprise.

With regard to the practical implementation of the privatisation process, the Council of Ministers decreed special Articles of Incorporation of the main body dealing with it – the so-called Privatisation Organisation. As mentioned earlier, it inherited the existing Organisation for the Promotion of Ownership of Production Units, is affiliated to the Ministry of Economic Affairs and Finance, possesses legal entity and is financially independent. With headquarters in Tehran and branches of representative offices throughout the country, the Privatisation Organisation was charged with a number of key duties and prerogatives with respect to divestiture of state ownership. Article 5 of the Articles of Incorporation enumerates them as follows:

- a) formulating proper guidelines in order to expedite and facilitate public participation towards the realisation of enhanced efficiency and increased productivity of material and human resources and development of potentials of the private and cooperative sectors, and presentation of the said guidelines to the High Commission of Divestiture;
- b) working out plans for enhancing the capabilities of the private sector and providing incentives to specialised groups and organisations and educating entrepreneurs;
- c) acting as proxy in matters of divesting shares of the companies slated for privatisation on the basis of the related regulations;
- d) offering shares of the saleable companies according to an approved time-table;
- e) implementing policies sanctioned by the High Commission of Divestiture;
- f) rendering any other action, operation and services towards execution of the programme of divesting shares and management of governmental corporations and privatisation within the framework of the laws and regulations;
- g) supervising the prompt execution of the terms of contracts relating to divestment, management, rent and performance of other matters entrusted to the organisation according to the contracts;
- h) performing other duties related to divestment of shares and privatisation that are entrusted to the organisation within the five-year development plans.

In terms of organs, the Privatisation Organisation consists of a General Assembly, an Executive Board, a Managing Director and an Auditing Officer, each of them with clearly defined duties and prerogatives. According to Article 7, the General Assembly consists of seven members: the Minister of Economic Affairs and Finance (President of the Assembly), the Head of the State Management and Planning Organisation, the Minister of Justice, the Minister of Industries and Mines, the Minister of Labour and

Social Affairs, the Minister of Commerce and the Minister of Cooperative. Decisions are taken by a simple majority of the members, which also constitutes the quorum for its meetings.

The meetings of the General Assembly are called by the President or at the request of the other institutions of the Privatisation Organisation. The duties that the General Assembly discharges through its work are enumerated in a ten-point list of Article 10.

They are:

a) to appoint and dismiss the chairman and the members of the Executive Board; b) to determine the salaries of the Managing Director and the Executive Board; c) to approve budgets, financial statements and the reports produced by the above two organs; d) to appoint the Auditing Officer and determine his/her remuneration; e) to sanction by-laws needed by the Organisation, including ones for employment, financial, administrative and business transactions; f) to adopt the general strategy of implementing the privatisation process and to approve the structure of the Organisation upon the consent of the State Management and Planning Organisation; g) to approve proxy fees and charges in connection to the sale of stocks; h) to make decisions concerning arbitration, to appoint arbitrator and to settle claims arising out of divestiture procedures; i) to propose to the Council of Ministers changes and amendments to the articles of incorporation; j) to take decisions concerning all other matters that according to the commercial law fall into the domain of competence of the general assembly, but are not determined in these Articles of Association.

Respectively, the Executive Board of the Privatisation Organisation consists of a Chairman (one of the undersecretaries of the Minister for Economic Affairs and Finance), who is simultaneously the Managing Director, and four other members elected by the General Assembly for a renewable period of three years. In the case of resignation, retirement or demise which results in a vacancy, it is filled through another election at the Assembly. The Executive Board can take decisions with a minimum of three votes. Among its duties are:

a) the preparation of annual budgets, financial statements and performance reports; b) the proposal of amendments to the articles of incorporation and the organisational structure; c) the proposal of settlement of claims and reconciliation to the General Assembly; d) the proposal of necessary by-laws and fees and charges in connection to the sale of stocks; e) the preparation of strategy plans for the Organisation in implementing the privatisation policy.

Notwithstanding the powers and duties of the General Assembly and the Executive Board, the highest executive authority within the Privatisation Organisation rests with its Managing Director. The duties of the position are:

a) implementing the policies, decisions and strategies formulated by the High Commission of Divestiture, the General Assembly and the Executive Board; b) annual budgeting in coordination with the Executive Board; c) preparation of financial statements for the Auditing Officer; d) the preparation of organisational charts, staffing policies, annual performance reports, etc.; e) presenting the Organisation before other legal persons and judicial authorities, governmental institutions and agencies, public, private and cooperative entities both domestic and foreign, with the right to appoint attorney and to propose reconciliation and arbitration to the Executive Board; f) defining the job description for the Organisation's staff and delegating duties and responsibilities in accordance with the respective laws.

Finally, the Auditing Officer (also called the Legal Inspector) is appointed for one year according to the employment regulation in the country. Re-appointment is permissible and the Articles of Incorporation do not specify the number of permitted re-appointments. There is also no specification, similar to the detailed enumeration above, of the duties and responsibilities of the Auditing Offices. Article 20 limits itself to simply declaring that his/her functions shall be in accordance with the relevant laws and regulations. Following this, the Articles of Incorporation wind up with miscellaneous provisions, among which Article 22 requires that the Privatisation Organisation prioritises the divestment of the shares which are in its possession at the time of its establishment. Article 24 states that the organisation should transfer 10% of its net profit

to the legal reserve account, which is required to be maintained at the level of the capital of the organisation.

### **5.3.1 *Analysis of Legal and Institutional Framework***

Such is, in fairly broad sketches, the legal and institutional framework of the privatisation process in Iran as outlined in the Third Social, Economic and Cultural Development Plan of the Islamic Republic (Privatisation Organisation, 2002). At face value it does not tell us much about the practical implementation of the process. As such, it brings to light a number of questions with respect to the background to this legal foundation, the interests and ideas that lie behind it and form its base, the modes and outcomes of the institutional interaction codified by it, as well as the practical results of actually carrying out the privatisation policy. The answers to these questions are crucial in making reliable statements and claims about the possible development of Iranian divestiture and its meaningful spread over the oil and gas sector, as well as about the opportunities available to foreign capital to make substantial inroads into the country's economy.

In the first place, at the conceptual level, it needs to be ascertained what the likely impact of the stated objectives would be upon Iranian enterprises and their privatisation. In other words, 'how does the country's elite see this relationship and what are the elements of contradiction and symbiosis between these two elements?' In economics, they are not mutually exclusive, but in politics they can often turn out to be so. Another related issue is the symbiosis that the official privatisation programme stipulates between politicians and company managers. How does this work out in reality? Both groups presumably have their own agendas and the process of reconciling them could easily produce a stalemate and conflicting ideas of the practical steps to be taken.

Secondly, at a more pragmatic level, there are a number of unclear positions in the institutional framework. An important one, for example, is the removal of privatisation claims for the judicial system of the country by creating a specialised Arbitration Committee subordinated to the Cabinet. Would this not impair the credibility of the whole process, or was it made precisely with this objective in mind? Similarly, various lines of accountability and relations of sub- and super-ordination need to be explained and analysed. Within the institutional set-up of the privatisation process, the Cabinet stands out as a central organ, which devises the policies, implements and controls them, and adjudicates arising claims. This of course is not done directly, but if one takes the rules stipulated for the appointment of relevant personnel, including the Privatisation Organisation, this is the conclusion at which one arrives. Why is this so? Does this not place Iranian privatisation in the vortex of political struggles, swinging it from one side to the other with every major political change?

The Cabinet is also charged with the important function of laying down the normative framework of by-laws that unpack the contents of the Third Social and Economic Plan (Privatisation Organisation, 2002). The Articles of Incorporation of the Privatisation Organisation, for example, come into effect through a Cabinet Decree (No. H23708/T/7858 of 16 May 2001) as do the by-laws for Article 14e (Decree No. H24285/T/24094 of 13 August 2001), Article 14f (Decree No. H24653/T/23511 of 8 August 2001), Article 15 (Decree No. H23743/T/4508 of 29 April 2001), Article 16 (Decree No. H24654/T/23760 of 11 August 2001) and Article 21 (Decree No. H23833/T/45536 of 2 January 2002) of the Third Socio-Economic and Cultural Development Plan of the Islamic Republic (Privatisation Organisation, 2002). Such a combination of legislative, executive and judicial power in one organ,<sup>108</sup> in this case the Cabinet, would potentially lead to closures (i.e. no-go zones and preferences) and a lack

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<sup>108</sup> Clearly, there are some contradictions and amalgamated functions. One example among many is the Minister of Economic Affairs and Finance who sits on the Assembly of the Privatisation Organisation, but who also plays a crucial role in the appointment of the members of the Arbitration Commission, which is supposed to be independently adjudicating the contracts prepared and signed by the Privatisation Organisation.

of transparency and consistency in implementing privatisation. Empirical research needs to be undertaken to establish to what extent this is true and how this limitation is perceived and addressed by the Iranian political, economic and religious elite.

Thirdly, at the most basic level of defining functions, duties and powers, the researcher has to consider the broad formulation of the responsibilities of the Privatisation Organisation. The first two are particularly (see the exhaustive enumeration above) broadly sketched and have no obvious relation to the practical task of transferring property from the public and private sectors. What is the reason for this? Does this automatically imply private ownership of domestic entrepreneurs only, once they have been trained and prepared for this by the Privatisation Organisation? In fact, the actual selling of shares comes only fourth in the functions of the organisation. The organisation itself seems to be overly saturated with institutions that parallel external ones (i.e. how does the General Assembly work with the High Commission for Divestiture or with the Arbitration Commission?). An overarching question is whether the system is workable at all. Following on from this are the issues of what kinds of networks form within and across these parallel structures, and how the different pieces connect and control each other. Are there relations enabling or hindering the privatisation process?

#### **5.4 The Oil and Gas Sector**

It has to be noted that the Iranian economy relies heavily on oil export revenues. They form around 80% of total export earnings, 50% of the government budget and 20% of GDP (USEIA, 2005).<sup>109</sup> As such, the economy's development is very much dependent on the price of oil. When it plunges, as during 1998 and early 1999, stagnation is a logical result. Conversely, when the prices go up, the government is enabled to finance

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<sup>109</sup> The following section is based upon USEIA (2005).

economic recovery. The relatively high oil export revenues in the past couple of years have allowed the setting up of an oil stabilisation fund, which provides a guarantee for governmental economic leverage in the case of price plunges. In a bid to ensure stability, the government has also attempted to diversify its activities by investing some of the oil revenues in other areas, such as the petrochemical industry.

In terms of its existing oil fields, Iran holds around 90 billion barrels of proven reserves, roughly 7% of the world's total, and claims another 30 billion barrels (so far unproved). The vast majority of the crude oil reserves are located in giant onshore fields in the south western region (Khuzestan) near the border with Iraq and the Persian Gulf. Iran produced 3.5 million barrels in 2002 and 3.9 million barrels in 2003 (USEIA, 2005). At the end of 2003, Iran's sustainable crude oil production capacity was estimated at around 3.75 million barrels per day. It is acknowledged, both domestically and internationally, that with sufficient investment, Iran could increase its oil production capacity significantly. This can be done through improving the efficiency of the operative oil fields, or through the exploitation of new ones.

By way of comparison, Iran produced 6 million barrels in 1974, which is almost double the amount produced in 2002 and in the years following the Islamic Revolution. The Oil Minister, Zanganeh, has acknowledged the need for upgrading and modernisation, since extraction from some of the fields has been carried out using methods damaging to their future production capacity. The current government has devised ambitious plans to double the national oil production, to more than 7 million barrels by 2015, and is counting on foreign investment to accomplish this; possibly as high as \$5 billion per year between now and then (USEIA, 2005). The production activities of NIOC are concentrated mainly on sustaining output levels from large, but ageing fields. This indicates that the oil sector is gradually becoming inefficient and is in need of modernisation through the introduction of advanced technologies and investment.



**Table 5.1: Iranian Oil Fields and Their Production Capacity**

<b>Major Iranian Oil Fields (estimated production, bbl/d)</b>	
<b>Onshore</b>	<b>Offshore</b>
Agha Jari (200,000 bbl/d)	Abuzar (125,000 bbl/d)
Ahwaz-Asmari (700,000 bbl/d)	Dorood (130,000 bbl/d)
Bangestan (around 245,000 bbl/d current production, with plans to increase to 550,000 bbl/d or more)	Salman (130,000 bbl/d)
Bibi Hakimeh (130,000 bbl/d)	Sirri A&E (95,000 bbl/d)
Gachsaran (560,000 bbl/d)	Soroush/Nowruz (60,000 bbl/d)
Karanj-Parsi (200,000 bbl/d)	
Marun (520,000 bbl/d)	
Pazanan (70,000 bbl/d)	
Rag-e-Safid (180,000 bbl/d)	

Note: Bbl/d = British barrels per day

Source: USEIA (2005).

With regard to consumption, the ratio between the exported amounts and those for the domestic market is approximately 67% to 33% (2.6 to 1.3 million barrels in 2003) (USEIA, 2005). The major overseas customers for Iranian Oil are Japan, China, South Korea, Taiwan and Europe. Iranian oil is traded on the spot market by NIOC's London division. Domestically, Iran's consumption is increasing rapidly, which reflects the steady growth of the economy and population. The Iranian government heavily subsidises the internal prices of oil products, to the amount of \$3 billion per year, which does not contribute to reasonable levels of consumption; instead it encourages waste and inefficiency. The gasoline policy could be helpful in this respect. Iran has to import it for domestic consumption and has been addressing the rising gasoline subsidy expenditure by raising the prices and introducing rationing restrictions. About \$5 billion

per year is imported. In addition, the domestic petroleum products are in effect subsidised, considering the price of crude oil and the cost of production, refining and distribution.

In the gas sector, the scope for development is much greater. Iran contains an estimated 940 trillion cubic feet (tcf) in proven natural gas reserves - the world's second largest and surpassed only by those found in Russia - of which 62% have not yet been developed (Ibid.). Due to its enormous reserve, Iran has the potential to become a significant natural gas exporter. In 2002, for example, Iran produced about 2.7 tcf of natural gas, some of which was used for enhanced oil recovery. In March 2004, Iran signed a \$1.2 billion contract with a consortium of two foreign and two domestic companies to gather natural gas from the Nowruz, Soroush, Hendijan and Behregansar fields (Ibid.). Russian Gazprom has also expressed interest in developing Iranian gas resources. Currently, natural gas accounts for nearly half of Iran's total energy consumption, and the government plans billions of dollars worth of further investment in the coming years to increase this share. The cost of gas to consumers is state-controlled at extremely low prices, encouraging rapid consumption, growth and replacement of the demand for oil.

In terms of privatisation, the Iranian Constitution (adopted following the Islamic Revolution) currently prohibits the granting of petroleum rights on a concessionary basis or direct equity stake. In 1987, the Petroleum Law was passed and enacted, which permits the establishment of contracts between the Oil Ministry, state companies and local and foreign national personal and legal entities. So far, the most often used system is the so-called 'buyback' agreement. According to it, NIOC concludes a contract with a company willing to invest in the development of new oil fields or the improvement of existing ones. Once in place, the buyback mechanism confers the obligation on the company (domestic or foreign) to fund all necessary investment for the project and the right to receive remuneration from NIOC. After the end of the contract, the operation of

the field is transferred back to NIOC together with the right to the whole revenue from sales.

Throughout the years of its implementation, the buyback mechanism has been assessed as having both drawbacks and positive elements for each of the two sides of the contractual relation (Personal Communication).<sup>110</sup> NIOC has no guarantee against a possible drop in oil prices; it has to pay the remuneration to the contractor anyway. So it bears the whole risk in the initial years of the project, and potentially faces payments larger than its revenues. Compensating this, it remains the sole proprietor of the field and the right-holder for all future revenues after the expiry date of the contract. In turn, the investor has no guarantee that they will not be prohibited from developing their discoveries after the initial investment. The current political system of Iran bears this risk by itself. Failing this, however, investors bear no risk of falling oil prices as they still receive the contracted remuneration for their work. If the oil price falls, the contractor will receive his payback over a longer period, thus in effect less financial reward. So the contractor also bears some of the risk of an oil price fall.

The current political risk in Iran stems largely from the antagonism between the conservative and reform-oriented forces. The former are embodied by the Council of Guardians (a 12-strong religious body formed after the Islamic Revolution), which has veto power over laws adopted by the National Assembly and supervises the elections. The latter are the base of President Khatami's overwhelming electoral victories in 1997 and 2001 and are embodied by his government. The conservative forces have been leading in the implementation of the nationalisation policies during the post-revolution period. As such, they vehemently oppose any efforts at economic liberalisation or the opening of state-owned enterprises to foreign investors and buyers. However, to the

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<sup>110</sup> Personal Communication. Discussions with Mr. Hossein Kazempour Ardebili, Deputy Minister of Petroleum/Head of Iran delegation to OPEC, Member of NIOC Board of Directors and Chairman of NICO, December 2005.

contrary, the reformists are willing and wishing to do exactly that, arguing that this is the only way the Iranian economy can recover in a sustainable way (Katouzian, 1989).

The conflict between the two opposing sides has been visible on at least two occasions with respect to the legal regulation of foreign investment. In May 2001, the National Assembly (then dominated by reform-oriented MPs) passed a bill on the attraction and protection of foreign investment. The next month, the Council of Guardians rejected it as being too liberal. Heavily amended, the bill was passed again by the National Assembly in November 2001. The following month, the Council of Guardians rejected it for a second time. Following a number of rebounds and consultations, the greatly weakened bill was finally adopted in May 2002 and approved by the Council of Guardians as the 'Law on the Attraction and Protection of Foreign Investment'. It aimed at encouraging foreign investment by streamlining procedures and guaranteeing profit repatriation. In fact, the law, which was sent to the government for implementation in January 2003, represents the first foreign investment act passed by Iran's legislature since the Islamic Revolution.

Similarly, the conservatives have proven to be potent in frustrating the economic policy of Khatami by introducing retroactive legislation and thus demonstrating disrespect for private property rights. After winning the February 2004 elections for the National Assembly, the conservative majority passed a bill which would allow them a veto over foreign investment. The Petroleum Bill was adopted in September 2004, but was backdated to March 2004. Under its provisions, foreign holdings of Iranian enterprises must be approved by the MPs. Its backers did not conceal their willingness to employ the bill in discontinuing a pair of deals with Turkish consortia who had previously conducted business with Israel and were thus considered to present 'security risks' for Iran. The first was the Turkish-Austrian group Tepe-Akfen-Vie, which had the concession to build Tehran's new Imam Khomeini airport. The second was Turkcell, which had earlier been awarded a \$3bn contract to build a second GSM network in Iran (BBC, 2004a).

Following Khatami's victory for the Presidency in 1997, NIOC and the Oil Ministry concluded a number of buyback contracts with large foreign investors in the oil sector. Despite the fact that some of them (see examples below) have been marred by corruption scandals involving foreign oil companies and high-ranking Iranian officials, they have brought considerable investment into the country. This policy is exemplary of the reformists orientation with regard to the economic development of Iran and is part of the political struggle in the country. Another of the restrictive acts of the current conservative majority in the National Assembly has been the rejection of a proposal to give oil exploration companies the right to exploit their discoveries.<sup>111</sup> The measure formed a central plank of Khatami's liberal economic plan, introducing privatisation and attracting more foreign investment. Currently, there are a number of buyback projects being implemented in Iran, several of which are presented below (USEIA, 2005).

A final agreement was signed in February 2004 on the \$2 billion Azadegan oil field development project, with the field being developed by Iranians (although Inpex is said to hold a 10% interest).<sup>112</sup> Azadegan was discovered in 1999, representing Iran's largest oil discovery in 30 years, and is located onshore in the south-western province of Khuzestan, a few miles east of the border with Iraq. Reportedly, Azadegan contains proven crude oil reserves of 26 billion barrels (USEIA, 2005), but the field is also considered to be geologically complex, making the oil more challenging and expensive to extract. In January 2001, the *Majlis* approved the development of Azadegan through a buyback scheme with a foreign investor. As the biggest importer of Iranian oil, Japan agreed to loan Iran \$3 billion in exchange for receiving the development rights for Azadegan. According to estimations, at its peak Azadegan production only could account for as much as 6% of Japan's oil imports.

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<sup>111</sup> It is unclear whether the National Assembly rejected the right of a company to develop its discovery. The company that made the discovery does not have an automatic right to exploit the discovery but is given priority and, under some conditions, can invest further and develop the field. Its share of production would be according to the buy-back agreements.

<sup>112</sup> It is reported that some Indian companies are also discussing involvement in this field.

Since 1995, NIOC has made several other sizable oil discoveries, including the 3-5 billion barrel Darkhovin onshore oil field, located near Abadan. In late June 2001, Italy's ENI signed a nearly \$1 billion, five and a half year buyback deal to develop Darkhovin. The contract contained a clause reducing the risk for the investor. The added incentive included a limited risk/reward element, whereby the payment of NIOC remuneration was linked to the production capacity of the oil field. This is a provision aiming to neutralise the disadvantages inherent in the buyback model and as such is a significant improvement of the Iranian oil development policy. Ultimately, the production capacity at Darkhovin oil field is expected to reach 160,000 barrels per day, which ranks it relatively high among other production sites.

The first major project under the buyback investment approach became operational in October 1998. The Sirri A oil field was developed and operated by Total and Malaysia's Petronas and began production at 7,000 barrels per day (USEIA, 2005). The neighbouring Sirri E field began production shortly thereafter (in February 1999). In March 1999, France's Elf Aquitaine and a consortium of Italy's ENI and Agip were awarded a \$1 billion contract for the recovery of the Doroud oil and natural gas field. The project had been intended to boost its production capacity by approximately 50% by 2004. In April 1999, Iran awarded Elf (46.75% share), along with Canada's Bow Valley Energy (15% share), a buyback contract to develop the offshore Balal field. Eni was also involved, with a 38.25% stake. The field, containing some 80 billion barrels of reserves, started producing at a 20,000 barrels per day rate in early 2003, and reached 40,000 barrels per day in February 2004 (Ibid.).

In November 2000, Norway's Statoil signed a series of agreements with NIOC to explore for oil in the Strait of Hormuz area. The agreement envisaged cooperation on the development of a processing plant for natural gas from four onshore fields and the possible development of the Salman offshore field at a cost of \$850 million (Ibid.). On 18 March 2005, a much sought-after contract to develop the Bangestan reservoirs in the three giant fields of Ahvaz, Mansuri and Abe Teymour. Bangestan projects were

awarded to Petro Iran Development Co. (a subsidy of NIOC), after having been delayed several times since 2001. Bangestan contains an estimated 6 billion barrels of oil reserves, but the field is one of the oldest in the country, requiring investment and technological applications to compensate for natural decline. Shell, Total and BP had been bidding for the project, but stated they were frustrated with the slow pace of negotiations and the numerous changes to its terms (Ibid.).

In May 2002, Iran's Oil Ministry signed another buyback contract (for \$585 million) with the NIOC subsidiary PetroIran to develop the Foroozan and Esfandiar offshore oil fields (Ibid.). PetroIran was expected to increase their production at the fields to more than 120% by the beginning of 2006. In January 2004, the Cheshmeh-Khosh field, which had previously been awarded to Spain's Cepsa for \$300 million, was re-awarded to the state-owned Central Iranian Oil Fields Company (CIOFC). In December 2003, Cepsa and OMV<sup>113</sup> withdrew from lengthy negotiations after a reported failure to agree on the development costs and the terms of the buyback project. However, both companies had stated they could still be involved at the site in some way under conditions acceptable to them.

Similarly, Iran has been employing the buyback model with natural gas resources. In September 1997, Total signed a \$2bn buyback deal, together with Russia's Gazprom and Malaysia's Petronas, to develop part of South Pars (Iran's largest gas field, part of what is most likely the largest gas field in the world). Total has a 40% share of the project, with the other two companies each having 30% (USEIA, 2005). Further on in the phases of the development project, ENI and Petropars will also be involved with the construction of onshore treatment facilities. Hyundai has also been contracted by NIOC, for \$1 billion, to build four natural gas powered trains. Shell and Statoil have also expressed interest in participating in the development of the South Pars gas field. Also

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<sup>113</sup> Austrian Drilling Oil Company.

active has been a consortium of national and international companies led by Norway's Aker Kvaerner.

In recent times, the Iranian government appears to have had some doubts about the viability and effectiveness of the buyback projects. Among such are a) recurring charges of corruption of high-ranking officials in the Oil Ministry and NIOC and its subsidiaries; b) insufficient benefits to Iran and its economy and c) worries that buybacks are attracting too little investment. There are signs that the reformist political elite is considering substantial changes in the system (Personal Communication).<sup>114</sup> In late May 2002, Canada's Sheer Energy became the first foreign company since the Darkhovin deal to reach an agreement under the terms achieved by ENI one year earlier. However, even this re-introduction of the limited risk/reward model has not attracted the amount of foreign energy investment that the Iranian economy needs.

#### **5.4.1 *Analysis of the Oil and Gas Sector***

It seems clear that the most important issue to take into account in the examination of what the determinants of Iranian privatisation policy in the oil and gas industry are, is the sheer size and importance of the oil and gas sector. The previous section, combined with the historical chapters (2, 3 and 4) illustrated this matter to a certain degree. Oil has been the lynchpin of the Iranian economy and has had an overwhelmingly important role to play in determining the nature of the Iranian economy, its political system and even its international relations. Although policy may determine the nature of the privatisation of the Iranian oil and gas industry, in many ways it is oil which is determining, and will continue to determine, the nature of policy - at both foreign and domestic levels.

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<sup>114</sup> Personal Communication. Discussion with Engr. Mohamed Hossein Nejad Hosseinian, Deputy Minister of Petroleum, International Affairs, Tehran, December 2005.



Chapters 2, 3 and 4 described the various ways in which oil has played a fundamental role in Iranian domestic and foreign policies and policy-making.

Beyond the size and importance of the Iranian oil and gas industry to Iran itself, we must also consider its importance to the world in general (Klare, 2005). It has been noted that only Saudi Arabia possesses more oil than Iran – 260 billion barrels, more specifically. Even Iraq, for which it has been argued that the US fought a war due to the strategic importance of its oil reserves, lies behind Iran with its (Iraq's) 115 billion barrels of oil in reserve. In total, it has been estimated that Iran has a full one-tenth of the world's total supply of oil (USEIA, 2005). These figures cannot be underestimated, although it should be borne in mind that estimations of total reserves can vary over time, depending upon accuracy of measurement, discovery of new fields etc.

We should not forget, on the other hand, that Iran's oil reserves are not the only resource in which we are interested and which have strategic importance for the world as a whole because of their sheer size. Iran, as already noted, has 940 tcf of natural gas reserves (PIIC, 2000). That is some 16% of the entire world's reserves of natural gas. The only other state with a larger reserve of natural gas is Russia, which has 1,680 tcf of natural gas in its reserves.

Translating the gas supply into terms of oil may help to demonstrate just how massive a resource we are actually discussing. Klare performs such a translation, noting that:

As it takes approximately 6,000 cubic feet of gas to equal the energy content of 1 barrel of oil, Iran's gas reserves represent the equivalent of about 155 billion barrels of oil. This, in turn, means that its combined hydrocarbon reserves are the equivalent of some 280 billion barrels of oil, just slightly behind Saudi Arabia's combined supply (Klare, 2005:1).

In other words, in terms of combined resources, Iran is one of the most important, if not the most important, states in the world.

At the same time, we must be careful to not only include the actual amount of oil and gas reserves in our calculations, but also the relative future production capacity of Iran versus other leading oil and gas producing states in the world. Analysts have noted that while Saudi Arabia has higher reserves than Iran, it is currently producing at about the maximum sustainable rate at which it can possibly produce oil (see, for example, Klare, 2005). This rate has been estimated at around 10 million bpd. Within the next two decades, it is unlikely that Saudi Arabia will be able to produce much more oil than that rate.<sup>115</sup> Yet, at the same time, the oil consumption of the world's leading oil-consuming countries – the US, China, and India – is estimated to rise by 50% in that same timeframe. In other words, there is going to be a much higher world demand for oil, and Saudi Arabia is unable to meet that demand.

Within this context of supply and demand in the world system, Iran has a significant potential to increase its yearly production of oil. Currently, Iran is producing around 4 million barrels per day (PIIC, 2000). However, it is capable of almost doubling that production value to 7 million bpd. This fact alone puts Iran in a league of its own in terms of its oil and potential for future oil production.

Moreover, Iran is not even nearly producing as much natural gas as it possibly could. Nowadays it produces approximately 2.7 tcf per year of natural gas. Given the huge size of its reserves (some 940 tcf), it is clear that Iran has a huge potential to increase the exploitation of its natural gas reserves (Koussari, 1999). Furthermore, it is one of the few countries which has such a potential, again putting it in a league of its own.

These statistics point to the degree to which oil and gas are not so much determined by but determine Iranian policy. There is significant pressure from all parts of the world for Iran to open and keep open its supplies of oil and gas. At the same time, oil and gas

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<sup>115</sup> Although Saudi Arabia's oil production capacity was about 10 million bpd in the past, this is being increased to about 12. Currently, it is probably about 11 or 11.5. Saudi authorities have announced that they have plans for raising capacity to 15 million bpd, but have not yet started to implement the necessary field operations for expanding to 15.

provide Iran with an extremely powerful bargaining chip in determining its foreign policy. To the degree that foreign policy determines the internal political and economic policies of a state, this factor will also affect Iranian policy in terms of privatisation of the oil and gas industry.

This brings us to what is probably the most important element in terms of oil and gas privatisation in Iran – that is, its strategic value. The sheer value of its reserves to the rest of the world, in particular to the world's most powerful countries (which also happen to be the countries which are most dependent on oil) leaves Iran with an enormous margin of negotiation. This is, for instance, visible in terms of the manner in which the nuclear issue is being dealt with by the US and Europe. It is, of course, a double-edged sword, for it also often implies that Iran is constantly under threat from other states who fear for the safety of the world's oil supply.

Therefore, at least since the revolution, Iran has continued to treat oil as a strategic resource. This means that the nature of privatisation of the oil industry will be different than that of any other privatisation process in Iran. Iran is not alone in viewing oil and gas in such a manner and of protecting it in terms of privatisation. As noted in Chapter 1, other states like Egypt and China have adopted similar perspectives for protecting this vital sector in terms of privatisation relative to other industries.

Thus, it is within this context that the discussion, in the previous section, on buyback and other models of Iranian oil and privatisation must be considered. Moreover, it is within this context that the future potential of oil and gas privatisation in Iran ought to be regarded. The concluding chapter of this study will return to this issue of the internal and external strategic importance of oil and gas. Yet, before that, we are going to approach the last factor determining the privatisation of the oil and gas industry in Iran, that is, the views of relevant policy-makers.

#### 5.4.2 *Relevant Policy-makers' Views*

There is an urgent need to reform Iran's economy, particularly since the fall of the Iranian stock market. This was essentially caused by Mahmoud Ahmadinejad's call to 'wipe Israel off the map' and the November 2005 presidential announcement that the general population of Iran would all receive shares in Iranian publicly-held industries. This was taken to be an initial step towards the seizure and re-distribution of the many private industries operating in Iran. As a result, there was a sudden and massive exit of capital from Iran, perhaps amounting to around US\$200 billion.

On his election to office in June 2005, President Mahmoud Ahmadinejad stated that he was against corruption. However, around 40% of Iran's GDP is accounted for by the Bonyads. These were essentially set up as charitable foundations, but are in actuality massive corrupt machines which bankroll the senior leadership. Such corruption has resulted in increased inflation and unemployment, reduced liquidity and investment, made the middle-class less well off, diminished non-oil exports, and further increased the gap between Iran's rich and poor.

Iran, consequently, has called for some US\$20 billion investment each and every year, in addition to US\$70 billion to recapitalise Iran's decrepit oil industry. One major problem is that there are only three capital markets in the world capable of such high investment levels - the US, Europe and Japan (Amini, 2004; Nili *et al.*, 2004). No other countries are able to substitute the place and power of the West in the near future. Also to be considered is the far superior technology available to the Western companies (Pollack, 2006). As a result, President Khatami realised the need for market reform and, in the absence of any other capital, advocated attracting foreign investment. He applied a short sharp shock to the market through some privatisation of state firms, further liberalisation allowing more freedom of expression to the people and popular press, and some changes to the labour laws.

President Khatami's government approved a massive programme of privatisation of state-owned companies (Reuters, 1999). Parliament also passed plans to modernise Iran's oil industry and almost double its production of oil over the next decade (USEIA, 1998). Such an increase in production has a cost (some \$120 billion), and Iran is looking towards its private investors and foreign sources for this capital. Iran has not yet discovered oil in the Iranian side of the Caspian Sea, but there is great potential for the discovery of oil and gas.

The final immediate determinant of Iranian privatisation policy for the oil and gas industry is the personal, subjective views of those policy-makers and policy-enactors who are concerned directly, or are otherwise relevant, to the said privatisation. Towards this goal, I have taken part in extensive primary research in order to assess these personal, subjective views. Two methods have been employed to assess these views; the first is a questionnaire filled in by relevant personnel, and the second is through first-hand interviews with some of the key members of personnel who filled in the questionnaires. In many ways, the human factor is one of the most important factors to take into account, because it is the most immediate one leading to the determination of policy. We are, in effect, literally asking what these men and women think as they are about to make a policy or otherwise influence it. In a way, their answers could be thought to provide an answer to the question of this thesis as a whole, therefore constituting the most important, perhaps even the only, determinant of oil and gas privatisation policy now and in the future.

Yet there are multiple problems and issues which arise in examinations like this that make such a simple answer untenable and the views of these individuals but one amongst many factors. These problems can be seen as involving, at their very base, epistemological and methodological issues.

Some of the epistemological issues have been discussed in the section above. Specifically, it was noted that there has been debate concerning the degree to which

historical and other structural factors truly affect the decision-maker's final decision (i.e. his or her agency). This issue comes up again in this section, although in another form. This time, however, the issue is that the determination of policy is not necessarily made in terms of what people think they think. Although it might sound confusing, the idea is relatively straightforward. Individuals may report that they believe they are going to make their decision based on a set of particular views, historical experiences etc., and then may, potentially, completely ignore such views and make a decision using other methods. This means that for the analyst, knowing these views, historical experiences etc., may not lead, necessarily, to a prediction of the decision-maker's action.

A related issue is that such 'misreporting' is particularly prevalent in the realm of politics. This is because decisions are made not only in terms of the policy-makers' own views, but also in terms of their constituency. Such a constituency may involve the people who elected them to office, those within a bureaucracy which they work in, or those to whom they must respond, such as religious personalities. Thus, the personal views of someone involved in politics may not necessarily lead to the actual policy implemented. At the same time, the political individual may misreport his or her views in order to please his or her constituency or to otherwise bring about an external (i.e. from the particular issue at hand) political goal. Thus, we must, in effect, take the results of such personal inquiries with a grain of salt.

These different epistemological issues force us to rely on other factors in order to answer the central question of this thesis ('what are the determinants of oil and gas privatisation policy in Iran?'). It is for this reason (the idea that the results of simply asking people what they think will not always answer your question), that the study has taken a multi-pronged approach in examining the determinants of privatisation policy. It has included theory, history and contemporary facts *on top of* the subjective views of policy-makers.

Related to these epistemological issues are methodological issues, which concern the nature of the analysis being undertaken (questionnaires versus interviews). There are also issues concerning the means by which these methodological implements and their findings are analysed. The following section will address these issues, before turning to an overview of the actual results and findings from the primary research.

#### *5.4.2.1 Analysis of Primary Research Methodology*

In any interview-based primary research there will be biases (Robson, 1997). This is due to the inherently biased nature of human interaction and, in a deeper sense, to the inherent biases in human thought. For instance, in the study of foreign policy, the field of International Relations specifically addresses such issues. An example is the bias brought on by bureaucratic placement. The old saying, 'where you sit determines where you stand' sums the problem up well – individuals are recruited and then initiated into not just a profession, but also a professional outlook on how problems should be solved and this outlook is reflected in their responses to questions or decisions.

However, these biases can be controlled. One way to control for them is to be very specific and frank about who is answering what question and how they answer it relative to others in a different situation. Of course, there are issues of confidentiality in providing the names of interviewees. However, it is generally acceptable to provide the organisation for which an individual works and, sometimes, their position. In this study, we have been able to provide such information. Thus, in the following sections, all responses will be tagged to individuals based on the organisation to which they belong. In order to safeguard the confidentiality of the replies from each of the individuals interviewed, or who replied to the questionnaire, the full and complete transcripts from each interview or questionnaire is not included in this thesis, but can be made available separately for examination, on request.

Another issue is that interviews often provide 'spotty' information (Robson, 1997). The limitations in time spent with an interviewee and the knowledge of any particular interviewee limit the amount of possible responses that can be obtained. It is therefore necessary to control this.

In this study, the entire inventory of questions was posed to each interviewee. This was done in the belief that an interviewee's inability to answer a question can tell us something about their view or organisational bias. For instance, it may be found that those in a particular bureaucracy are unable to answer questions about the public's perceptions of privatisation as a rule, whereas in another bureaucracy they may have more insight. This could then tell us something about the ability of one bureaucracy to be sensitive to the public's perceptions relative to another bureaucracy. It also limits the bias of the interviewees by leading them down the same thought pattern that each of the other interviewees has been led down during the interviews. For instance, it may be the case that an interviewee will respond to a question concerning the public's perceptions of privatisation if oil and gas is mentioned as a topic of study first, since otherwise they may simply be considering privatisation in general, but afterwards they may think of it only in regard to oil and gas. Finally, it is the belief of this author that by asking all questions, sometimes you 'just get lucky'.

The inventory of interview questions is listed below in order to provide the reader with an understanding of the nature of each interaction with the interviewee, what they were considering at the time, and what the realm of possible responses is expected to have been. The interviews were split into questions concerning the following topics: background and privatisation policy, legal framework, implementation, outcomes and follow-up, the public's perceptions on privatisation, political influence, and the oil and gas sector specifically.



### **Background to the privatisation policy:**

- What have been the main debates leading up to the formulation of the Iranian privatisation policy? At least three categories of debates must be analysed: academic, political, and economic.
- Were there differences of opinion between the team in charge of the practical drafting of the law and the Cabinet? If yes, on what issues?
- To what extent has the expert opinion played a role? Or was it largely marginalised in favour of political considerations? What was the profile of the expert group in charge of drafting the privatisation law?
- Which actors (politicians, religious elite, interest groups, formal and informal associations, etc.) were most involved and put most weight in drafting the initial privatisation legislation and its subsequent by-laws and amendments?
- Does the privatisation framework favour a particular social, economic, political, etc. group? Does it make clear a distinction between domestic and foreign capital? If so, why?
- Why did so much time elapse between 1995 (when the privatisation programme of Iran was officially inaugurated) and 2000 (when the Third Plan actually codified procedures and institutions)? What are the reasons for this delay?
- In those five years who were the most active actors in pushing for the actual privatisation codification and the go-ahead for the Iranian privatisation programme by the Third Plan?

### **Legal framework:**

- Did the privatisation legislation regulate the most important issues? If not, what were the areas that were insufficiently regulated or omitted altogether? How did this change at later stages?

- Consistency of legislation: are the by-laws decreed subsequently by the Cabinet in accordance with the general framework set out in the Third Plan? Who were the initiators and the most influential actors in devising the by-laws?
- What are the main areas allowing for discretion of key institutions and officials in charge of carrying out the privatisation programme? How has this discretion been exercised and to whose benefit?
- Within the legislative and institutional set-up who has come to be the central and most influential institutional actor? Why?

### **Implementation:**

- What is the level of political control and interference in the privatisation process? Are there concrete examples of how this was done in practice?
- Methods of privatisation: who is in charge of selecting among various privatisation methods? Which ones are the most frequent types used? What are the most common types of preferences and closures?
- Who is responsible for evaluating assets of companies identified for privatisation? Has this practice been abused?
- Are there detailed criteria that have to be met for the privatisation deal to be approved?
- What was the most common form of breaching the legislation on privatisation? How are such cases dealt with?
- What is the practical impact of the relationship between enhancing economic efficiency and privatisation, which is clearly stated in the laws and regulations?

### **Outcomes and follow-up:**

- Who are currently the main winners and losers in the privatisation process?

**Public perceptions on privatisation:**

- To what extent was privatisation something of importance to local people?
- Has this changed during the past ten years?

**Political influence:**

- Has the direction of the privatisation programme changed with changes in government?
- Is there any political purpose performed by the oil and gas sectors, i.e. is it a politically intensive industry in the sense that the way it is being regulated creates dis/advantages to different political parties?

**The oil and gas sector:**

- How much has been already privatised in the Iranian oil and gas sector?
- What trend do statistics reveal, i.e. in which direction is Iran moving – a global strategy for the whole sector or compartmentalising it and deciding different strategies for each separate area?
- Has the legal and institutional framework been devised to account for substantial privatisation and modernisation in the oil and gas industry?

As is apparent from the above questions, the interviewees were each given a wide swath of issues to comment upon. Of course, all interviewees did not comment on each issue at length. However, the response rate was high enough to draw a number of conclusions. The following section will detail the findings from these interviews.

## **5.5 Findings From the Primary Research**

A total of fifty people were contacted and discussions were held with all of them, although, strictly speaking, only 32 interviews were performed. The interviewees included representative members of industry, government and academia. The full list of these interviewees is provided in Appendix IV.

Furthermore, a total of 100 questionnaires were sent out to representative members of the government and academia in Iran. Only seven completed forms were returned. In some cases the questionnaire was filled out and the individual was interviewed separately. The low figure of returned questionnaires is in itself a valuable piece of information, and proves that the more qualitative approach of interviewing people worked better in this case. Appendix V contains a list of those who returned their questionnaires.

Based on these interviews and the questionnaires which were filled out, it is possible to draw some generalisations and conclusions. The majority of this thesis has taken a structural level approach to the analysis of factors influencing privatisation policy in Iran. By generalising the results of these interviews, it is possible to add to this structural level approach (Silverman, 2000). This was done through a process of detailed comparison of interviewees.

These general findings can be roughly split into two categories. First, there are the perceptions about why, how, when and what kind of privatisation will take place. Second, there are the perceptions about what groups are influencing the privatisation policy and how they are doing so.

### 5.5.1 Why, How, When and What Kind of Privatisation

Some interviewees (see Appendix IV) suggested that there were structural factors involved in the decision to privatise in Iran. In particular, the relative price of oil is thought to play a major role in the possibility, or at least the pace, of the privatisation of the oil and gas industry in Iran. As one interviewee remarked:

There has been a direct correlation between lower oil prices and faster pace for privatisation. Every time the price of oil has dropped in the international market, the pace and the impetus for privatisation has picked up. When in 1989/1990 the talk of privatisation started, right after the Iran – Iraq war, Iran hit the bottom of the selling price for its exports of oil. When this phenomenon is present, the government thinks seriously about reducing its cost of running its vast operations and therefore thinks of divesting itself of the companies it operates (Interview: Dr. Parviz Aghili, Managing Director, Karafarin Bank, Tehran, 29 December 2005).

Whatever the structural issues involved, it is generally assumed amongst most elites that the process of privatisation will make the Iranian economy more efficient and profitable. Furthermore, it is assumed that this process may also lead to better prospects for the government of Iran, in that it will have an increase in income from the burgeoning economy and less need to pay out. For instance, the following quotes were taken from several different interviews:

The effect of privatisation [on the economy] will improve the profitability of the entity and hence will benefit the workers and the shareholders alike. Furthermore, this will reduce the size and the burdens of the government enabling it to regulate and supervise the activities, to everyone's benefit (Interview: Mr. Houshang Naderian, Chairman & Managing Director, Audit Organization, Tehran, December 2005).

Other benefits noted were that privatisation will:

- (a) ...abolish all governmental restrictive policies and procedures enabling the management to act quickly for the benefit of the organisation.

(b) [Reduce] in the size of the government and hence, its overall expenses.

(c) [Distribute] the assets and holdings amongst ordinary people. [Increasing] profitability (Interview: Mr. Hossein Mamdooh, Member of Board of Directors, Iran Helicopter Services Company (IHC) and Head of Quality Assurance, Tehran, December 2005).

Although there is a clear logic behind the drive to privatise, most interviewees also noted that there were significant delays in implementing privatisation. While some pointed toward the structural effects of issues like the price of oil, as noted above, others simply noted that there were inefficiencies in the system. For example:

The loss of time and the delays were the direct result of the lack of knowledge and clear-cut policies of the officials at the start. The firms that were privatised initially ended up in sacking its workers and ended in the closure of those production units and, hence, created the delays in establishing clearer ideas and methodologies for privatisation (Interview: Mr. Hossein Mamdooh, Member of Board of Directors, Iran Helicopter Services Company (IHC), Tehran, December 2005).

These kinds of inefficiencies are to be expected given the size of the undertaking. However, it was not clear what the relationship was between these inefficiencies and other structural effects, nor was it clear which issues elites considered to be more causal. One factor that came up was that there were too many control and interest groups involved. As one interviewee noted:

There are too many controls and interferences. This is the reason for the slow pace with which this process has moved forward since its inception. A case in point is when the oil ministry decided to sell off its drilling activities and privatise this division. Economically it was a viable proposition but since it was not accepted politically, this plan was set aside (Interview: Dr. H. Ghanimi Fard, Executive Director, International Affairs, NIOC Petroleum Ministry HQ, Tehran, 22 December 2005).

Another factor is that changes in government, as expected, have led to changes in privatisation policy. As one source remarked:

Unfortunately, every time a new government takes over, the privatisation programme goes through some modifications. It is as if they wish to re-invent the wheel, by putting their own signature on the agenda. By making the alterations and refitting the programme to suit their personality and to have their own signature on the scheme, much valuable time has been lost in the past (Interview: Mr. Iraj Nadimi, MP / Deputy Head of *Majlis* Economic Committee, and university lecturer, Tehran, 24 December 2005).

Although many interviewees seemed to agree that privatisation was a necessity and that at some point there would be a certain degree of privatisation of the oil and gas industry, there was not always agreement on which parts of the industry would be privatised. However, one of the recurrent views was that downstream oil and gas industry would privatise before upstream ones. For instance, one interviewee noted that:

It seems to me that the downstream activities [marketing, distribution, transportation, refining] are more prone to being privatised in the short term (Interview: Dr. Narsi Ghorban, Managing Director, NarKangan (NGTLC) Gas to Liquid International Co., Tehran, 18 December 2005).

One factor in particular is the capital intensiveness of an upstream industry. As one interviewee noted:

I do not feel we are going to see a move in the upstream side of the oil industry being privatised as yet. There are a number of sections in the downstream side of the oil and gas industry that have already been privatised, and shall continue this trend. However, there are limits to privatising capital-intensive units i.e.: the refineries which are being heavily subsidised. The distribution, tanker company, and some others have already been sold off to the oil company pension fund organisation, before they go onto the Tehran Exchange, for a full-blown privatisation and IPO (Dr. H. Ghanimi Fard, Executive Director, International Affairs, NIOC Petroleum Ministry HQ, Tehran, 22 December 2005).

Another interviewee noted that politics might play a role in the privatisation of upstream versus downstream industries. He noted that:

It does not appear to be a politically intensive industry, but it is. There are politicians who wish to stay close to the industry and this naturally breeds politicians trying to place their own close associates to run sections of this industry. I do not think that the politicians are going to have much effect on the upstream side of the industry. However, they probably will exert pressure in the downstream side of oil and gas, through their contacts and connections that they try to promote into positions of power in the sector (Interview: Dr. Mehdi Assali, President, Institute for International Energy Studies (IIES), Tehran, 19 December 2005).

### **5.5.2 For or Against**

The question of politics leads naturally to the issue of what groups within Iran are for or against privatisation. In fact, the general consensus was that oil and gas privatisation in Iran is a fundamentally political issue. As one interviewee remarked:

...petroleum and all its by-products are politically influenced and politically intensive commodities. Naturally, the industry is also motivated by the political agenda. There are certain people who could profit by keeping the oil sector this way (Interview: Mr. Hassan Lajevardi, Lecturer and, Deputy Director Econ. Research, Centre for Energy Studies-MATN, Tehran, 20 December 2005).

Put more boldly, which are the interest groups involved? The interviews and questionnaires made it possible to get some idea of who the elites perceive as being the relevant interest groups on each side of the equation.

Different interests groups have different views on the issue and each group attempts to bring about its policy choice. Yet, most interviewees seemed to believe that the privatisation plan in theory does not favour one group over another. However, they also



tended to believe that it is the lack of transparency and complexities of the process which has “left a bad taste” in some people’s mouths. For instance, one academic noted:

From the looks of it, [privatisation] does not appear to be favouring a particular segment of the public. At the beginning the implementation of some of the production units took place by direct negotiations. This left a bad taste for many who were watching, whilst the de-nationalisation of these assets ended up in favour of the political elite’s cronies (Interview: Dr. Ebrahim Razaghi, Professor of Economics, Tehran University, Tehran, 26 December 2005).

Nevertheless, although the privatisation plan may not specifically favour one particular group over another, there are clearly winners and losers in the privatisation plans in Iran, and this has created interest groups on both sides who are pressurising the process. These groups do not necessarily make the decisions on privatisation directly, but nonetheless, they seem to have some effect on the decision-making process, at least in the eyes of elites.

Broadly speaking, some sources thought of the well-connected and those involved in the political system as being beneficiaries of privatisation.<sup>116</sup> This political elite is generally thought to be harmonious in its backing. As one interviewee noted:

There is harmony and consensus amongst the political elite. The differences are usually pronounced in some using privatisation as a tool to balance their yearly budgets, whilst others think of it as the engine for economic progress and development. These two differing opinions are probably still in place (Interview: Mr. Houshang Naderian, Chairman & Managing Director, Audit Organization, Tehran, December 2005).

While the political elite is perceived as being for privatisation, all in all, the civil servants were not behind nor for this idea. As was noted:

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<sup>116</sup> For instance, as noted by Dr. Aghili, Managing Director, Karafarin Bank, Tehran, 29 December 2005.

The biggest problem of the consecutive governments has been that they have become 'competitors of the people', rather than passing on the management of the companies to the people. The ministries who have been asked to divest themselves of the companies under their wing are reluctant as they see this as a reduction of their 'reach, or their powers' (Interview: Engr. Mohamed Hossein Nejad Hosseinian, Deputy Minister of Petroleum, International Affairs, Tehran, 18 December 2005).

Another interviewee noted that:

[the] winners are the employees as a whole and the selected capable management of the newly privatised institutions. The losers are the narrow minded old government managers who have taken over the privatised institution and are too afraid of taking risks or bringing about new ideas which could improve the competitiveness and profitability (Interview: Mr. Hossein Mamdooh, Member of Board of Directors, Iran Helicopter Services Company (IHC), Tehran, December 2005).

As expected, such views tended to be most prominent in interviews with those who were themselves part of the major government bureaucracies.

Also similarly to other states, in Iran those on the left side of the political spectrum have tended to oppose privatisation. For instance, one interviewee noted that:

Yes, there were those leftist oriented cabinet ministers who were against the privatisation and deep down inside did not wish to see the plan for privatisation succeed. Whilst they gave lip service by saying yes to the concept, in reality, they were not believers in the programme (Interview: Dr. Parviz Aghili, Managing Director, Karafarin Bank, Tehran, 29 December 2005).

Also, as we might expect, such views tended to come from those who were already involved in privatised businesses (i.e. from those more on the right).

Moreover, as is the case in other states, the unions were also seen as stumbling blocks. For example, one interviewee noted:

There were no direct objections to the privatisation plans, except, we have seen the unions and middle management were putting stumbling blocks on the way of implementing this programme. They were afraid of losing their jobs. These same workers were those who helped to bring about the revolution and therefore, in the current labour laws, out of 203 Articles, 102 Articles are in place to protect the workers against the owners! The labour laws have to change if privatisation is to succeed (Interview: Dr. Ali Hamadani, Legal Advisor, Society for Industrial Management, Tehran, 17 December 2005).

Interviewees also addressed their perceptions of the feelings toward privatisation among the bulk of society (the 'masses'). It is generally assumed amongst the elite that privatisation is something which mainly affects and concerns elites. The masses are thought to take little interest in it, not to know about it, or simply not to care very much one way or the other.

The masses, i.e. blue-collar workers, farmers, and generally the common people, are not too bothered by this concept. The academics, management people, upper middle classes with knowledge of economic issues, this concept is considered to be very important (Interview: Mr. Houshang Naderian, Chairman & Managing Director, Audit Organization, Tehran, December 2005).

One reason for this is that:

[the] public has not had a choice or a say in the matter. They do not know how to differentiate between the private and public sector entities. [However] ...the public is gradually becoming more educated about differentiating between private and public sector (Interview: Dr. Parviz Aghili, Managing Director, Karafarin Bank, Tehran, 29 December 2005).

In some cases, interviewees did point out that the masses were against privatisation. For instance, one interviewee, the Deputy Minister of Petroleum, remarked that:

The common people and the masses do not think favourably of this concept. They think here is another way for the 'rich to get richer' ploy. They think of this issue as yet another way of

auctioning away what belongs to the future generations. The reason is that they have yet to see a successful outcome from the entities that were privatised (Interview: Engr. Mohamed Hossein Nejad Hosseinian, Deputy Minister of Petroleum, International Affairs, Tehran, 18 December 2005).

In particular, it was thought that in some cases:

...the local people see this process going against the distributive policies of the government. To this end, they are not favourable to this agenda (Interview: Dr. Abbas Maleki, Chairman, International Institute for Caspian Studies, Tehran, 24 December 2005).

Although the interviewees noted that there were several different constituencies which were either for or against privatisation, they all tended to understand who was specifically responsible for making privatisation policy. For example, this interviewee put it very concisely:

The Privatisation Organisation is charged with this task. However, the Central Bank of Iran, Economic Committee, Tehran Stock Exchange and MPO (Management and Planning Organisation) can all have inputs into the discretionary issues raised on privatisation of the companies belonging to the government sector. They could also present a bill through the Cabinet of Ministers, and once ratified by Majlis and Expediency Council, the Privatisation Organisation will implement the execution (Interview: Mr. Ali Khorram (Former Ambassador to China), Deputy, High Council of Free Trade – Industrial Zones Secretariat, Tehran, 17 December 2005).

A related point is the fact that some of the respondents also addressed the question of whether the change in government would affect privatisation in Iran (i.e. would a change in the constituency change the policy?). As this thesis has tended to argue, there are strong structural issues that govern privatisation in Iran and these will likely force it through or not regardless of particular governments (at least in the short term). This view also tended to be accepted by elite members in the interviews. Moreover, the

conventional view was that these structural causes would eventually lead to privatisation. As one interviewee concisely put it:

No. The privatisation programme will survive. The society wishes for this to happen (Interview: Mr. Ali Khorram (Former Ambassador to China), Deputy, High Council of Free Trade – Industrial Zones Secretariat, Tehran, 17 December 2005).

## **5.6 Analysis of Relevant Policy-maker Views**

Although this thesis has tended to point out the differences between Iran and other states in order to tease out the effects of Iranian idiosyncrasies on privatisation, there are some similarities between Iran and other countries in terms of structural constraints on privatisation. In particular, bureaucratic power seems to be playing a large role, particularly in terms of elite perceptions. For instance, many interviewees made the point that one of the primary obstacles to privatisation has been middle managers' and other bureaucrats' reticence in losing their influence.

Similarly, there were some notable class differences in Iran which seem to have an effect on the future of privatisation in the eyes of political, business and academic elites. Almost all interviewees noted these differences, although not all of them thought that the differences would lead to the same results. For instance, some thought that the poor were ambivalent about privatisation, while others saw them as being very much against it. Yet, most believed that the political elite in general was for privatisation.

It is evident from this discussion that this chapter is totally based on field surveys. These surveys are of special importance in the analysis of the privatisation process in Iran because they reveal the inside story of the situation. The outcome of these surveys suggests that:

- It was widely believed and experienced that privatisation reduces the burden of the government.
- There was a mixed feeling that the privatisation process should be carried out through the stock exchange and/or through limited tender/negotiation, and dealings should be focused on potential and genuine buyers.
- Due to limitations in the various sections of the constitutional laws related to foreign investment, there has not been significant progress in attracting foreign investment.
- Interest and pressure groups had a major role in the decision-making process of privatisation and in its implementation.
- From the beginning of this process, there have been disputes and debates between the religious elite and other influential bodies.

These structural factors need to be accounted for in our overall analysis. In this sense, the interviews and questionnaire data have proved useful in the overall political, economic and theoretical analysis of privatisation in Iran. The conclusion to this study will put this subjective data into the broader context of the entire thesis and thereby lead to some final thoughts about the answer to the question of this thesis.

## **CHAPTER 6: CONCLUSION – PROSPECTS FOR THE FUTURE**

### **6.1 Summary of Argument**

The aim of this thesis was to examine the issues surrounding privatisation of some of Iran's national institutions, focusing on the oil and gas industries. By determining the critical factors which influenced such policy-making, some understanding of the reasons for both the public and private sectors' reluctance to enter into privatisation has been gained. More specifically, this study has investigated the specific privatisation policy determinants in order to ascertain whether there actually is the political will to privatise the Iranian oil and gas industries. To answer this question, various sub-themes were addressed, including the Iranian domestic, external and international environments over the past sixty years, along with the past privatisation policies of both Iran and other states.

The thesis started by presenting an overview of the theoretical basis of privatisation, by detailing schools of thought. The central question of this study was also examined by looking at the opportunities for privatisation at a theoretical level, then looking at other examples of privatisation. Specifically, it looked at privatisation in Pakistan, Azerbaijan, Kyrgyzstan and India, along with the non-neighbouring states of Egypt and China. This methodology has enabled further refinement of its answer to the study question, by discussing and developing an understanding of the opportunities open to Iran for privatisation.

Through a political economic approach, Chapters 2, 3 and 4 examined the historical aspects which led to the present discussions of Iranian oil and gas privatisation. Each chapter explored a specific era of Iran's history. Chapter 2 looked at the post-Second World War period, dominated by the Shah, which led to the 1979 revolution. Chapter 3 then examined Khomeini's rule from 1979 to 1989. Finally, Chapter 4 addressed the

contemporary situation in Iran, from 1989 to the present. Each of these chapters explored in detail the political and economic issues, culminating in an analysis of the interplay between these factors.

With such theoretical and historical contexts established and in place, this thesis then addressed more specifically the contemporary determinants of Iran's privatisation policy. The next chapter, Chapter 5, then critically examined the four primary factors which directly affected Iran's privatisation policy.<sup>117</sup>

## **6.2 Summary of Conclusions**

Taking all of the chapters together we can draw some conclusions as to what the determinants of privatisation policy for the oil and gas industry are in Iran. These determinants are wide-ranging and based on the multiple perspectives and methodologies used in this case study. Each chapter has drawn its own conclusions, which have been summarised and analysed. The following paragraphs summarise these conclusions.

### **6.2.1 *Theoretical and Precedent-Based Conclusions***

Part Two of Chapter 1 examined the theoretical boundaries and precedent constraints on the determination of privatisation policy in Iran. In doing so, it effectively defined the landscape within which privatisation possibly takes place in Iran.

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<sup>117</sup> The four being the specific background of privatisation thought in Iran; the legal and institutional framework; the nature of oil and gas relative to privatisation in Iran; and the personal thoughts of relevant policy-makers.



It was found that there are at least four theoretical factors that must be taken into consideration in our analysis of privatisation of the Iranian oil and gas sector. These are:

- the definition and understanding of what privatisation is;
- the boundaries set by other forms of economic change and alternatives to privatisation;
- the different possible types and shades of privatisation; and
- the limits and obligations within any privatisation deal, as set by the basic concept of the right to property.

Within these theoretical bounds, the empirical information and historical background of privatisation were incorporated within each chapter.

There were also some specific lessons to be learned from the different models of privatisation that were investigated, as well as from the historical precedents of privatisation. These lessons contribute directly to the policy-maker's decision-making process, showing that:

- even though privatisation may be agreed upon, the nature of the method of privatisation will have a huge effect on the timeframe upon which privatisation is actually carried out and this factor must also therefore be considered in analysis and predictions for future investment;
- it is often assumed that, in theory, there will be a fairly correct analysis by the government and that policy will conform to this. However, we must keep open the possibility that such an assumption may be wrong and that the government may simply make a mistake;

- different industries may or may not privatise depending on their type; specifically, so-called ‘strategic’ industries, including the oil and natural gas industry, will tend to privatise differently from other non-strategic industries;
- we must keep the possibility of other such options open when considering what decision-makers in Iran are taking into account, e.g. based upon precedents, in their analysis of whether to, and how to, privatise the oil and gas industry in Iran; and
- political infighting over privatisation is the norm, not the exception to the rule, and this is a double-edged sword. For, even in the case that the core of the Iranian government decided not to privatise the industry, there would still be the hope of a debate and that out of this debate, there would emerge a possibility for compromise. Thus, potential parts of the industry could be subject to privatisation or there may otherwise be changes in the prospects for privatisation.

Finally, it was discovered that the Iranian state-controlled economy has been unsuccessful in improving the lives of its people, as promised by the founder of the Islamic Revolution and repeated by its current President, Mahmoud Ahmadinejad.

### ***6.2.2 Political Economy Conclusions***

The political economic analysis performed in the historical chapters (2, 3 and 4) demonstrated that there is an interplay of domestic and international political and economic factors that has been the determinant of the Iranian policy of privatisation. Each of these factors was explored separately.

The first factor is the disjunction between Iran's government and society. This issue is theorised by what Katouzian (2000, 2003) has called the theory of 'arbitrary rule'. This factor has traversed time and affected all governments in Iran, even after the revolution of 1979.

The second factor is the disjunction between economic and political/social modernisation. This disjunction was examined in relation to the Shah's attempts at economic and political reform, then continued on past the revolution and into today.

The third factor in determining policy is Iran's dependence on oil. Oil played a major role in the Shah's Iran and has continued to do so since the revolution. It has skewed and biased both domestic and international policy in the state through to the present day.

The fourth factor to consider is the relationship of Iran with the West (and the US in particular), and Iranian society's perception of this relationship (including the legacy of Anglo Iranian Oil Co and the coup against Dr Mosaddeq). In particular, the perception of the West's imperialistic attitude towards Iran had significant effects on the nature of Iran's policy before the revolution and has continued to do so since.

These four factors have all helped to determine the nature of Iranian policy in regard to privatisation throughout the history of Iran, going back at least to the Shah. These factors continued into post-revolution Iran due, in part, to the brevity of the Iranian revolution. Beyond these factors, there are two supplementary factors that have had significant sway since the revolution.

The first supplementary factor is the role of the Islamic Republic's revolutionary ideology. After the revolution, politics and economics in Iran showed some continuities with pre-revolution Iran, but huge changes were also experienced. The revolutionary ideology led to changes in the government, including factionalisation, as well as changes in foreign policy. These included, specifically, the Iran hostage crisis, and

Iran's handling of the Iran-Iraq War and the Gulf War. Another key issue has been the Iranian relationship with nuclear power and nuclear weapons.

The second supplementary factor is the role of religion in Iran. In particular, religion has had a complex, and very direct, relationship with privatisation in Iran. However, it has also had other effects on politics and economics in Iran, such as the complex relationship of Khomeini's views on the revolution with his views on fundamentalist Islam.

### **6.2.3 *Contemporary Iran-Based Conclusions***

Chapter 5 analysed, from a contemporary perspective, four of the primary factors affecting privatisation in Iran. It examined the background issues that led up to the current views of privatisation in Iran. It also studied the role of legal and regulatory issues in privatisation. It looked at the unique importance of oil and natural gas in Iran. Finally, it incorporated the primary fieldwork information in terms of the personal, subjective views of relevant Iranian policy-makers and policy enactors.

The general conclusions to be found here in terms of legal, regulatory and oil issues are fairly straightforward. Legal and regulatory issues are, at the broadest level, tools of policy. While there are uncertainties in the effects of the legal and regulatory policies already on the books, these uncertainties are at the mercy of even more fundamental issues – these being the immense role played by oil and the role of elites.

As was demonstrated, oil plays an immense role in the economic and political life of Iran. Because of this, and in particular, because of its strategic importance, it holds a special place in terms of privatisation. Therefore, it is not necessarily helpful to consider oil and gas privatisation in terms comparable to other industries. As such, it was helpful in this study to take a more direct look at some of the specific concerns of elites in Iran.

As was alluded to in the more theoretical political economy sections of this study, there is a relevant difference between those in the government or connected to its higher echelons (the 'elite') and those who are not (the 'common people'). Since the elite are the ones who are actually writing the policy, it was helpful to look at their perceptions of privatisation in Iran in particular, as well as their perceptions of non-elite influence on privatisation policy. The difference in these views is well summarised by one interviewee in particular, who notes that:

The blue-collar workers and the farmers had no clues as to what was and is going on. The higher income and middle management as well as the political elite and policy-makers think very highly of the privatisation scheme (Gholam Hassan Abiri, Lecturer, MPO and Tehran University, Applied Economics Research, Tehran, 19 December 2005).

Yet, although these differences in opinion exist, and even within the elite there is a difference in that it was generally accepted that privatisation would happen, the question that the elite were more concerned with was how fast it would happen – due to systemic delays, as well as which parts of the oil and gas industry would be privatised. Thus, although the government has recently shifted in Iran and foreign relations have been changing radically since 2001, there is still a widespread feeling that privatisation will happen because of fundamental structural issues.

### **6.3 Summary Chart and Final Conclusion**

Taking together all of the points discussed in the preceding chapters, it is possible to draw up a chart which summarises these factors.

**Table 6.1: Factors Determining Iranian Privatisation Policy**

	<b>Factors Determining Privatisation</b>					
<b>Historical and Political Economy</b>	Disjunction between state and society	Disjunction between economic and political/social modernisation	Economic dependence on oil	Relations and perceptions of relations with the West and US	Revolutionary ideology	Religion
<b>Theoretical</b>	Theories of privatisation			Alternatives to privatisation		
<b>Precedents</b>	Neighbouring states: Pakistan, Azerbaijan, Kyrgyzstan and India			Other important states: Egypt and China		
<b>Specific</b>	Background of privatisation	Legal and institutional factors	Oil Sector	Personal perceptions of policy-makers		

Source: Privatisation Organisation (2004).

Thus, we are able to conclude that the answer to the thesis question posed is this: privatisation policy in Iran will be determined by several interacting factors including the disjunction between state and society, the disjunction between economic and political/social modernisation, Iran's economic dependence on oil, relations and perceptions of relations between Iran and the West (and the US in particular), the Islamic revolutionary ideology and religion, as well as through theories of privatisation and international precedents of privatisation.

### **6.3.1 *Summarising Major Themes***

The conclusion made in the previous section is, in a sense, a sufficient summary of the factors that affect the prospects of privatisation in Iran. However, based on a reading of the themes that have emerged throughout this study, it is possible to make a more inclusive and conceptual conclusion. The two themes in particular that are key here are Iranian exceptionalism and structural factors.

### **6.3.2 *Exceptionalism***

This thesis has found, in both its primary and secondary research, the persistent theme of Iranian exceptionalism. Although many states have come to privatise their national industries, it seems that the case of Iran is somehow exceptional. This view permeates through much of the literature on Iran and its economy, and is further illustrated in this study. The particular factors leading to this exceptionalist view, which were addressed throughout this study, come down to the role of religion and revolution in Iran.

Religion creates exceptionalism in terms of Iranian privatisation, due to Iran's fundamental basis in Islamic theocracy. This has meant that all politics and economics are affected, to some degree, by Islam, and in particular, by the dictates of Shia' Islam. For example, Chapter 4 discussed the effects of Islamic thought on the Iranian economy.

However, there are other Islamic states, and even ones that are also dependent on oil. For instance, we might also look at Saudi Arabia. However, Iran differs from these other states in that it is not only a theocratic state but also a revolutionary one.

The Iranian revolution and its aftermath had an immense and, to a certain extent, unique impact on Iran. For example, it was discussed how the revolution led to foreign policy crises in Iran, as with, for instance, the hostage crisis. At the same time, there has been

an echo of the revolutionary policies that has led all the way up to present day political and economic decisions.

Together, these factors (religion and revolution) have led to the exceptionalism of Iran and Iranian privatisation policy more specifically. As noted, academics both within and outside of Iran hold this view. It was also prominent in the interviews and questionnaire responses carried out as part of the *primary* research for this study.

For this reason, we should not take it to be the case that we can understand privatisation in Iran purely in terms of the theoretical or comparative factors previously discussed in this study. These theoretical and comparative issues were of some help in contextualising Iranian privatisation. However, Iran differs fundamentally from other cases of privatisation that have been discussed here in terms of direct comparisons or more theoretical issues. The relevant difference, of course, arises out of the fact that Iranian policy and economics is affected to such a high degree by religion and revolution. As such, it has been necessary to take a very specific look at Iran – one which has taken into account many issues that might not be relevant in other state privatisation examples.

Yet, although this thesis has tended to point out the differences between Iran and other states in order to tease out the effects of Iranian idiosyncrasies on privatisation, there are some similarities between Iran and other countries in terms of structural constraints on privatisation. In particular, bureaucratic power seems to be playing a large role, particularly in terms of elite perceptions. For instance, many interviewees made the point that one of the primary obstacles to privatisation has been middle managers' and other bureaucrats' reticence at losing their influence.

It was argued that Iranian exceptionalism is the result of a combination of the effects of religion, revolution and bureaucracy. In this line, it is suggested that the Iranian five-year development plans reflect some aspects of this combination including, among



others, the pernicious effects of an inefficient bureaucratic power. Iranian five-year central planning, first established in 1979, appears as the coalescence of religion and revolution in the form of Islamic Marxism. Over time, the effects of central planning and the views on it have varied. When analysing the outcome of the Third Development Plan covering 2000-2004 (Privatisation Organisation, 2002), the most recently completed plan, Amuzegar suggests that:

Five-year central planning has now become a sacred ritual in the Islamic Republic... and although [it] has proven to be a costly exercise in futility, it is still regarded as a talisman for Iran's economic salvation (Amuzegar, 2005:61).

Djavad Salehi-Isfahani, Professor of Economics at Virginia Tech, suggests in turn that planning has become more indicative than centralist and that it fulfils a necessary function of coordination between the private sector and the government (Samii and Aman, 2005).

It ought to be said that Amuzegar is not entirely negative about the outcomes of the Third Plan either. He claims that these outcomes were much better than those of the previous Plan (the Second Development Plan) (Privatisation Organisation, 2002), yet he insists in pointing out the lack of effective formulation of the development goals and the lack of meticulous implementation that seemingly characterise the Third Plan. It is suggested that both kinds of deficiencies are typical features of vast and largely ideologised state machineries like the Iranian administration. Furthermore, the lack of commitment among the different levels of bureaucrats to conform to the plan mandates and, at the same time, the unrealistic nature of some of the goals are also emphasised by Amuzegar as contributing factors to the partial failure of the Third Plan. Finally, Amuzegar (2005:61) also denounces that no real progress has been made in price decontrols and in privatising money-losing state enterprises under the Third Plan.

The successor of the Third Plan, the Fourth Plan, was approved in September 2004 and contains six parts (Privatisation Organisation, 2004). The first part, which delineates 57 articles aiming at the development of a “knowledge-based growth of the national economy in interaction with the global economy”, along with the sixth part, devoted to “good governance and the modernisation of the state” appear to be the most relevant ones for the context of privatisation (Ibid.). Beyond the more obvious concern with rapid economic expansion, there is clearly an interest in addressing the issues pointed out by Amuzegar (2005) in relation to the current inefficiency of the state apparatus (by improving governance and modernising the functioning of the public administration) which have direct implications for privatisation. However, the Fourth Plan (Privatisation Organisation, 2004) had a shaky start. According to some legislators, the by-laws and instructions required to commence the implementation of the plan had not been prepared in time and had to be designed ‘on the march’ (Samii and Aman, 2005). This kind of amending dynamic, that is, the practice of designing the actual implementation measures as the central plans unfold instead of planning ahead, seems to have become the rule within the Iranian administration. For all these reasons, it is suggested that the notion of exceptionalism is applicable in the context of government central planning, and that the five-year development plans actually reflect some key aspects of the triad that sustains the notion: religion, revolution, and bureaucracy.

Finally, there are also some perceivable class differences in Iran which seem to have an effect on the future of privatisation in the eyes of the political, business and academic elites. Almost all interviewees noted these differences, although not all interviewees thought that the differences would lead to the same results. For instance, some thought that the poor were ambivalent about privatisation, while others saw them as being very much against it. Yet, most believed that the political elite in general was for privatisation.

Nevertheless, while these issues have played a role, they do not override the importance of religion and revolution. This is illustrated by the very fact that Iran has not privatised

its oil and gas industry in the same way or as fully as other countries which do not have the same exceptionalist issues to deal with.

### **6.3.3 *Structural Factors***

Combined with this exceptionalism, there are also structural factors that need to be taken into account in terms of understanding the privatisation of oil and gas in Iran. For instance, Giddens's (1984) concept of structuration was discussed. At this point it is helpful to fully account for these effects.

There are multiple structural factors that have had, and will continue to have, an overwhelming causal effect on privatisation in Iran. These include:

- the gradual shift of Iranian internal and foreign policy towards a more pragmatic approach due to the realities of internal and foreign policy realities, as opposed to revolutionary ideologies;
- the growth and shrinking of the Iranian economy over time, and in particular in relation to oil prices;
- the gradual trend towards inefficiencies in the Iranian economy as the nationalised oil economy has evolved over time and in relation to the regional and global economy;
- the evolution of internal Iranian politics, in particular, in regards to its having a younger and more educated population which is more connected to the outside world; and finally
- in this sense the exceptionalist role of religion and revolution and these factors' evolution over time also count as structural factors.

Together, these factors are more fundamental than any particular policy or politician in Iran. They are also more relevant than any particular external foreign policy or political event, including the war in Iraq or the ongoing nuclear crisis. As such, privatisation in Iran must be understood within the context of an ongoing structural progression.

In particular, we should conclude that these structural factors have been inextricably pushing Iran towards privatisation. This is clear at a theoretical level in terms of the need to deal with inefficiencies in the Iranian economy. It is also clear from the fact that Iranian privatisation policy has continued to move forward, though at a variable pace, for over a decade. Finally, this was made clear in the views of the elites who were interviewed for this study.

#### **6.4 Factors in the Determination of Political Will and Prospects for the Future**

Yet, such a conclusion should not be taken too far. Although this study finds that privatisation will happen in Iran, it is less clear how and when privatisation will occur. Three factors must be taken into account in order to make more precise conclusions and find more precise implications. These are the role of unpredictability in internal politics, the effects of the global economy, and the differences inherent to Iran's oil and gas economy, especially in regard to upstream and downstream privatisation.

The main issue for Iran at the moment is its nuclear stand-off with the international community. What is obvious, taking into account the paradox of the 3 July 2006 declaration of Ayatollah Ali Khamenei, is that the resolution of this crisis will impact on the future course of Iran, not just in terms of its foreign policy, but also in terms of its domestic politics, its economy and potentially even the nature of the state itself.

#### **6.4.1 *Problem of Unpredictability***

An important issue covered in Chapter 5, which we promised to return to, is the problem of the admission of unpredictability in national politics. In particular, Chapter 5 noted that the recent election of Ahmadinejad was taken by some analysts to be unexpected. And, importantly for this discussion, the particular policies and policy paths which he has chosen and will choose are not necessarily those which align with the point made above (i.e. that there has been a reversion to the pursuit of modernity and that modernity is causal to privatisation policy in Iran).

This issue is particularly important with regard to the implications from this study and, especially, for our ability to make predictions of what will happen in the political, economic and oil spheres. Specifically, it forces us to ask the question of whether we really can make any predictions, even based on the significant amount of background, historical and theoretical information which this thesis has brought forth.

At the least, we must accept that the pace and extent of privatisation will be determined, to some degree, by changes in Iranian politics. Although we have come to the clear conclusion that privatisation will happen regardless of the changes in Iranian politics, changes in the leadership of Iran (such as in the form of the election of Ahmadinejad) do have an effect on the pace of privatisation. In particular, we might conclude that in the case of Ahmadinejad's election, privatisation's progress in Iran will be slower than it might have been if, for instance, Rafsanjani had won the election.

#### **6.4.2 *The Effect of Globalisation on Iran***

This study has continually brought out the effects of the regional and global political system and economy on Iran. This began long ago with the British and American's placement of the Shah with an economic rationale. It continues through to today. Even though Iran separated itself, and was in turn separated from many other states after the

revolution, globalisation has meant that it cannot escape the effects of the global economy and other states' foreign policies – if it ever could. Iran's view of globalisation is a tool in the hands of the former coloniser and the current superpower to legitimise the neoliberal global project; that is, the creation of a global free market and the consolidation of Anglo-American capitalism around the world (Held and McGrew, 2002). In post-revolutionary Iran, there has been no sustained dialogue between globalisers and the Iranian political elite. The revolution swept away the secular, pro-Western elite and delivered the state to Islamists, thus removing the thesis against which Islamist antithesis could react. Instead of becoming a tool with which to forge a synthesis with globalisation, the Islamic state turned in on itself, both because of the imposition of sanctions by the US and because of the perceived need to consolidate and defend the revolution (Henry and Springborg, 2001). Notwithstanding this phenomenon, I contend that Iran has and will be sensitive to global issues, since the elasticity of its oil revenues is linked to its awareness and connection to the global systems.

A particularly significant issue to account for is the role of world oil prices. As was noted in the primary research of this study, changes in oil prices affect the prospects of Iranian privatisation of the oil and gas industry. To simplify the matter, when oil prices are relatively high, privatisation progress tends to slow; when oil prices are relatively low, privatisation progress tends to speed up.

The logic behind this is fairly straightforward: as high oil prices mean that oil is worth more to the Iranian government and therefore it is less willing to part with it. Moreover, since the government of Iran has more money at such times, it is able to make up for inefficiencies in the economy and support itself, remain politically stable and, in general, prop up the overall economy. Therefore, it does not need to reform and privatise the oil and gas industry. The logic goes in reverse as well: when oil prices are low, the government has less money to prop itself up and maintain the overall economy (due to, for instance, the need to subsidise various products and industries). This means

that it is forced to look for ways to make the economy more efficient and privatisation is an obvious way to do this.

#### **6.4.3 *Upstream Versus Downstream Oil Privatisation***

Chapter 5 pointed out that there is a discernable difference in the prospects of upstream versus downstream privatisation in Iran. This point needs to be further reinforced. In particular, we need to take into account three factors: oil and gas are considered to be strategic industries in Iran, and Iranian exceptionalism.

The oil economy in Iran is strategic on multiple levels. At one level it is necessary in order to keep the total Iranian economy afloat since its economy is so dependent on oil as an export that brings in foreign capital and as a means of employing (or subsidising) a large number of people in Iran to some degree. At the same time, Iran's oil and gas gives it significant strategic weight in its dealings with neighbouring and global states in that it can threaten to lower or end oil and gas exports. Finally, oil and gas are used generally as a means of strategic trade, for instance, as illustrated by recent deals between Iran and China. Together, these factors mean that Iran cannot easily let go of its control over its oil and gas economy, especially at the hands of companies based in states that may potentially be enemies.

The strategic value of Iran's oil and gas industry is compounded by Iranian exceptionalism. As noted, Iran's politics and economics are dictated to some degree by religious and revolutionary undertones. In this respect, other states (and even companies from other states) are seen through the lens of revolution and (different) religion. This means that Iran should be seen as even less trusting of international agreements, including economic ones, than other states.

Together, this has led to a reluctance to privatise the oil and gas industry in general. By extension, it has led to Iranian reluctance to privatise some parts of the oil and gas industry relative to other parts of the industrial sector. In particular, Iran has been less willing to privatise those areas of the oil and gas industry which are more relevant to Iran, and which make the country more dependent on other states. In other words, it is less willing to privatise upstream oil and gas industry than it is to privatise downstream oil and gas industry.

## **6.5 Implications and Prospects of Iranian Privatisation**

Thus, we can draw some implications and prospects for the future out of the conclusions of this study. These prospects can be summarised into three areas: continued privatisation, pacing being dependent on internal politics and global oil prices, and privatisation of the downstream oil and gas industry followed later by upstream industry.

An important overall conclusion to this study is that privatisation will happen in Iran. This privatisation will include the privatisation of the oil and gas industry. This is demonstrated by the structural drivers of Iran's political and economic system, and is independent of short-term political or economic changes. Rather, the question of privatisation in Iran is a matter of pacing and extent.

The pacing of Iran's privatisation of the oil and gas industry will depend on multiple factors. Of particular importance are the changes in the internal political situation and changes in global oil prices. Internal political changes, such as the continued governance (or re-election) of Ahmadinejad, will lead to a slowdown in the pace of privatisation. Nevertheless, privatisation will continue to move forward. Similarly, privatisation will be dependent, to a degree, on world oil prices. In particular, prospects



of continued high world oil prices leads to the conclusion that privatisation will continue at a slower relative rate in Iran. For the privatisation of oil and gas to succeed in Iran, there is a need to restructure the state organisation. In particular:

- National financial matters must be tackled by professionals and not on the basis of their political affiliations.
- At present, the country lacks a clear and comprehensive investment policy, and rules and regulations attached to investment, particularly foreign investment. The government should hire independent professionals from both within and outside the country to review the existing rules and regulations in Iran.
- There is a requirement to overhaul the bureaucratic system now in place. Independent financial consultants should be invited to provide objective solutions to the process of investment by local and foreign investors.
- Tax and labour laws will need to be overhauled, enabling investors to make short, medium and long-term plans for their investments. Furthermore, tax and labour laws should create an investment-friendly environment to attract foreign investment in investment-intensive projects.
- New regulatory and 'watch-dog' organisations should be created to monitor each phase of the investment to performance of the privatised institutions.

Finally, the extent of privatisation in Iran will depend on the relative strategic importance of the industry in relation to the exceptionalist factors of Iran's politics and economic system. This means that we can expect a continuing fast pace of privatisation in non-strategic areas such as farming. Within the oil and gas industry, we can expect

that downstream industries will privatise at a relatively faster rate than upstream industries. Even so, eventually we can expect both upstream and downstream industries to become fully privatised.

Although Ahmadinejad (current President of the Islamic Republic of Iran) was elected on a platform that featured anti-corruption, it seems highly unlikely, now that one year has passed since his election, that he will be any more effective at alleviating the plight of the Iranian people than President Khatami - and he may even make circumstances worse. Ahmadinejad, as a perceived pious man, is committed to fighting corruption, but it is hard to imagine that the regime will allow him to do anything meaningful, because it is the regime itself that is the principal engine and beneficiary of this corruption. Likewise, whilst Ahmadinejad campaigned on a platform of economic reform, his vision of this was a take on the populist version of 1970s' socialism. Unfortunately, Iran needs less socialism, not more. It needs fewer price controls, more privatisation, more private investment and more free enterprise.

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## APPENDICES

**APPENDIX I:**  
**COVERING LETTER FOR QUESTIONNAIRE,**  
**WITH ENGLISH TRANSLATION**

برادر / خواهر

ارجمند

.....

با سلام و عرض خسته نباشید، به استحضار جنابعالی می  
رساند پرسش هایی را که ملاحظه می فرمایید در رابطه با  
مبحث خصوصی سازی در ایران و برای تکمیل رساله دکتری  
اینجانب رضا مولوی، دانش آموخته دانشگاه دوره‌ام  
انگلیس، طراحی و تنظیم شده است. خواهشمند است Durham  
در صورت امکان با پاسخگویی به سوالات مطرح شده،  
اینجانب را یاری فرموده تا هر چه سریع تر رساله دکتری  
را به پایان برسانم. یقین دارم که مساعدت جنابعالی بدون  
اجر معنوی خواهد بود. در ادامه توجه جنابعالی را به  
چند نکته مهم برای پاسخگویی به سوالات مطرح شده جلب  
می نمایم:

- 1- پاسخ های خود را به صورت مختصر و مفید قید  
بفرمایید.
- 2- در صورت نیاز به فضای بیشتر برای پاسخگویی، می  
توانید از يك برگه سفید دیگر با ذکر شماره پرسش  
مطرح شده استفاده نمایید.
- 3- در صورت تمایل، برگ رزومه ضمیمه را تکمیل نمایید.
- 4- پاسخگویی سریع به پرسشنامه موجب امتنان خاطر  
خواهد بود.

در پایان بر خود واجب می دانم از مساعدت بیدریغ  
جنابعالی کمال تشکر را بنمایم.

رضا مولوي  
فارغ التحصيل دانشگاه دورهام انگلیس

## ENGLISH TRANSLATION:

Dear Sir / Madam,

With greetings and salutations, I enclose the questionnaire that I have constructed to address Iran's Privatisation programme which forms the final part of the research I am conducting towards completion of my doctorate at Durham University.

I would be grateful if you could kindly respond to the questions in the questionnaire in an effort to assist me in drawing my conclusions to this research work. Whilst your efforts in this undertaking will not have a material gain for you, I am certain that it shall be profitable in spiritual benefits.

In conclusion, I would wish to draw your attention to a number of key issues in responding to the questionnaire.

1. Please be as concise as possible in your responses to the questions.
2. In case you need more room for your responses, please use a blank page with the question number clearly stated on the page.
3. Should you agree, kindly fill in the resume' page, also attached, about yourself.
4. Your early return of the questionnaires with your answers will be greatly appreciated.

Finally, it is incumbent upon me to thank you for your cooperation. I am most grateful and indebted to you.

Yours sincerely,

Reza Molavi  
Ph.D. Candidate, School of Government &  
International Affairs  
Durham University

## APPENDIX II:

### QUESTIONNAIRE, WITH ENGLISH TRANSLATION

مصاحبه خصوصی‌سازی در ایران - رساله دکتر!

رضا مولوی

#### ● پیشینه سیاست خصوصی سازی در ایران

1- به نظر شما، مهمترین موضوعاتی که زمینه را برای تدوین و تنظیم سیاست خصوصی سازی کشور آماده کرد، کدام بودند؟ لطفا در پاسخ خود حداقل به سه مورد اقتصادی، سیاسی و نظری اشاره فرمایید.

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3- آیا از مشخصات و صلاحیت های حرفه ای کار گروه  
تنظیم سند خصوصی سازی کشور اطلاع دارید؟ اگر پاسخ  
مثبت است، لطفاً به چند مورد مشخص اشاره فرمایید.

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4- چه گروههایی از میان سیاستمداران، روحانیون،  
سازمانهای دولتی و غیر دولتی و سایر افراد ذینفع  
بیشترین تاثیر را بر مراحل مختلف تنظیم و تدوین سند  
خصوصی سازی کشور گذاشته اند؟



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6- به نظر شما چرا در فاصله سالهاي 1374 - زمان آغاز رسمي برنامه خصوصي سازي کشور- تا 1379 - زمان تنظيم و تدوين برنامه سوم توسعه - اتفاق خاصي در زمينه خصوصي سازي در کشور رخ نداد و به عبارت ساده تر دلایل تعويق برنامه چه بود؟

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7- در فاصله زمانی مذکور، 1374-1379، کدام اشخاص یا سازمانها در تنظیم و تدوین برنامه خصوصی سازی کشور و به تحرك واداشتن آن در خلال اجرای برنامه سوم توسعه، نقش فعالتری را ایفا کردند؟

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چارچوب حقوقی برنامه 

8- آیا قانون خصوصی سازی کشور موضوعات و مباحث مهم خصوصی سازی را شامل می شود؟ اگر چنین نیست، به نظر









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لجرای برنامه خصوصی سازی کشور

12- به نظر شما سطح کنترل سیاسی و مداخله در فرایند خصوصی سازی کشور تا چه اندازه می باشد؟ آیا مثال های عینی در این رابطه وجود دارد که نشان دهد کنترل و مداخله به چه نحوی صورت می پذیرد؟

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13- در رابطه با روش های خصوصی سازی، چه کسی/  
سازمانی مسوول انتخاب و گزینش روش مناسب خصوصی  
سازی در کشور از میان روش های عدیده موجود است؟ به  
نظر شما، کدام روش ها در این زمینه متداول تر  
هستند؟

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14- چه کسی / سازمانی مسوول ارزش گذاری اموال شرکت های مشمول خصوصی سازی در کشور است؟ آیا می دانید که ارزش گذاری اموال به چه شیوه ای صورت می گیرد؟

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15- آیا از ملك هاي مخصوصي براي انجام معاملات خصوصي  
سازي در کشور استفاده مي شود؟

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16- رایج ترین و شایع ترین شکل تخطي از قانون  
خصوصي سازي کشور چه بوده است؟ در صورت بروز تخلف  
نحوه برخورد با آن چگونه است؟



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**نتایج و پیامد های خصوصی سازی**

برندگان و بازندگان حال حاضر فرایند خصوصی سازی کشور چه کسانی هستند؟

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**برداشت عمومی از فرایند خصوصی سازی کشور**

به نظر شما، خصوصی سازی تا چه اندازه از نظر عامه مردم مهم تلقی می شود؟

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به نظر شما، آیا این رویکرد در خلال 10 سال گذشته در میان مردم کشور تغییر کرده است؟

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## بخش نفت و گاز کشور

تا به حال چه اندازه از بخش نفت و گاز کشور قانون زدایی شده است؟

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24- بر اساس آمار و ارقام های موجود، آیا برای پیشبرد صنعت نفت و گاز کشور باید از یک استراتژی واحد جهانی استفاده کرد و یا این که برای هر یک از بخش های آن به صورت مستقل از یک استراتژی بخصوص بهره برداری نمود؟

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25- آیا برای خصوصی سازی اساسی بخش نفت و گاز کشور یک چارچوب حقوقی و سازمانی مخصوص مد نظر قرار گرفته است؟

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26- آیا برای مدرن سازی صنعت نفت و گاز کشور يك  
چارچوب مشخص طراحی شده است؟

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رزومه شرکت کنندگان در مصاحبه

نام و نام خانوادگی:

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ميزان تحصيلات:

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رشته تحصيلي:

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سمت:

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سن:

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آدرس محل کار:

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شماره تماس:

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پست الکترونيك:

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# **ENGLISH TRANSLATION OF QUESTIONNAIRE**

## **Questionnaire on privatisation in Iran:**

We are conducting a survey concerning the context, legal and institutional framework, and future of privatisation. Your comments on this questionnaire will be very helpful in furthering our research.

Please fill out the answers to the questions below in the space provided. If you need more room to answer a question, feel free to use another sheet of paper. If you feel unable to answer a question, you may leave the space blank.

Thank you for your time.

## **Background to the privatisation policy:**

- 1) What have been the main debates leading up to the formulation of the Iranian privatisation policy? At least three categories of debates must be analysed: academic, political, economic?





- 6) Why so much time elapsed between 1995 (when the privatisation programme of Iran was officially inaugurated) and 2000 (when the Third Plan actually codified procedures and institutions)? What are the reasons for this delay?
- 7) In those five years who were the most active actors in pushing for the actual privatisation codification and the go-ahead for the Iranian privatisation programme by the Third Plan?

### **Legal framework**

- 8) Did the privatisation legislation regulate the most important issues? If not, what were the areas that were insufficiently regulated or omitted altogether? How did this change at later stages?

9) Consistency of legislation: are the by-laws decreed subsequently by the Cabinet in accordance with the general framework set out in the Third Plan? Who were the initiators and the most influential actors in devising the by-laws?

10) What are the main areas allowing for discretion of key institutions and officials in charge of carrying out the privatisation programme? Please give examples. How has this discretion been exercised and to whose benefit?

11) Within the legislative and institutional set-up which has come to be the central and most influential institutional actor? Why?



16) What was the most common form of breaching the legislation on privatisation? How are such cases dealt with?

17) What is the practical impact of the relationship between enhancing economic efficiency and privatisation, which is clearly stated in the laws and regulations?

### **Outcomes and follow up**

18) Who are currently the main winners and losers from the privatisation process?

### **Public perceptions of privatisation**

19) In your opinion, to what extent privatisation was something of importance to local people?

20) Do you believe that this has changed during the past ten years?

### **Political Influence**

21) Has the direction of the privatisation programme changed with changes in government?

22) Is there any political purpose performed by the oil and gas sectors, i.e. is it a politically intensive industry in the sense that the way it is being regulated creates dis/advantages for different political parties?

### **The Oil and Gas Sector**

23) How much has been already deregulated in the Iranian oil and gas sector?

24) What trend do statistics reveal, i.e. in which direction is Iran moving – a global strategy for the whole sector or compartmentalising it and deciding different strategies for each separate area?

25) Has the legal and institutional framework been devised to account for substantial privatisation in the oil and gas industry?

26) Has a framework been devised to account for modernisation in the oil and gas industry?







3- لطفا با ذکر مثال بیان نمایید در کدام زمینه های مهم، به اشخاص و سازمانهای دست اندرکار اجرای برنامه خصوصی سازی اجازه داده شده تا در صورت لزوم بنا به صلاحدید خود عمل نمایند؟ این آزادی عمل چگونه و به چه نحوی بوده و به نفع چه کسانی تمام شده است؟

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ⓐ اجرای برنامه خصوصی سازی کشور

4- به نظر شما سطح کنترل سياسي و مداخله در فرآيند خصوصي سازي کشور تا چه اندازه مي باشد؟ آیا مثال هاي عيني در اين رابطه وجود دارد که نشان دهد کنترل و مداخله به چه نحوي صورت مي پذيرد؟

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5- آیا از ملاک هاي مخصوصي براي انجام معاملات خصوصي سازي در کشور استفاده مي شود؟

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برداشت عمومی از فرآیند خصوصی سازی کشور

به نظر شما، خصوصی سازی تا چه اندازه از نظر عامه مردم مهم تلقی می شود؟

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نفوذ سياسي در فرآيند خصوصي سازي کشور □

7- آیا جهت برنامه خصوصي سازي کشور با تغيير دولت در ايران عوض مي شود؟

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8- به نظر شما، آیا صنعت نفت کشور يك بخش كاملا سياسي است كه هر نوع تغيير و تحول در آن به نفع يا عليه گروههاي سياسي کشور تمام مي شود؟

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9- آیا برای خصوصی سازی اساسی بخش نفت و گاز کشور يك چارچوب حقوقی و سازمانی مخصوص مد نظر قرار گرفته است؟

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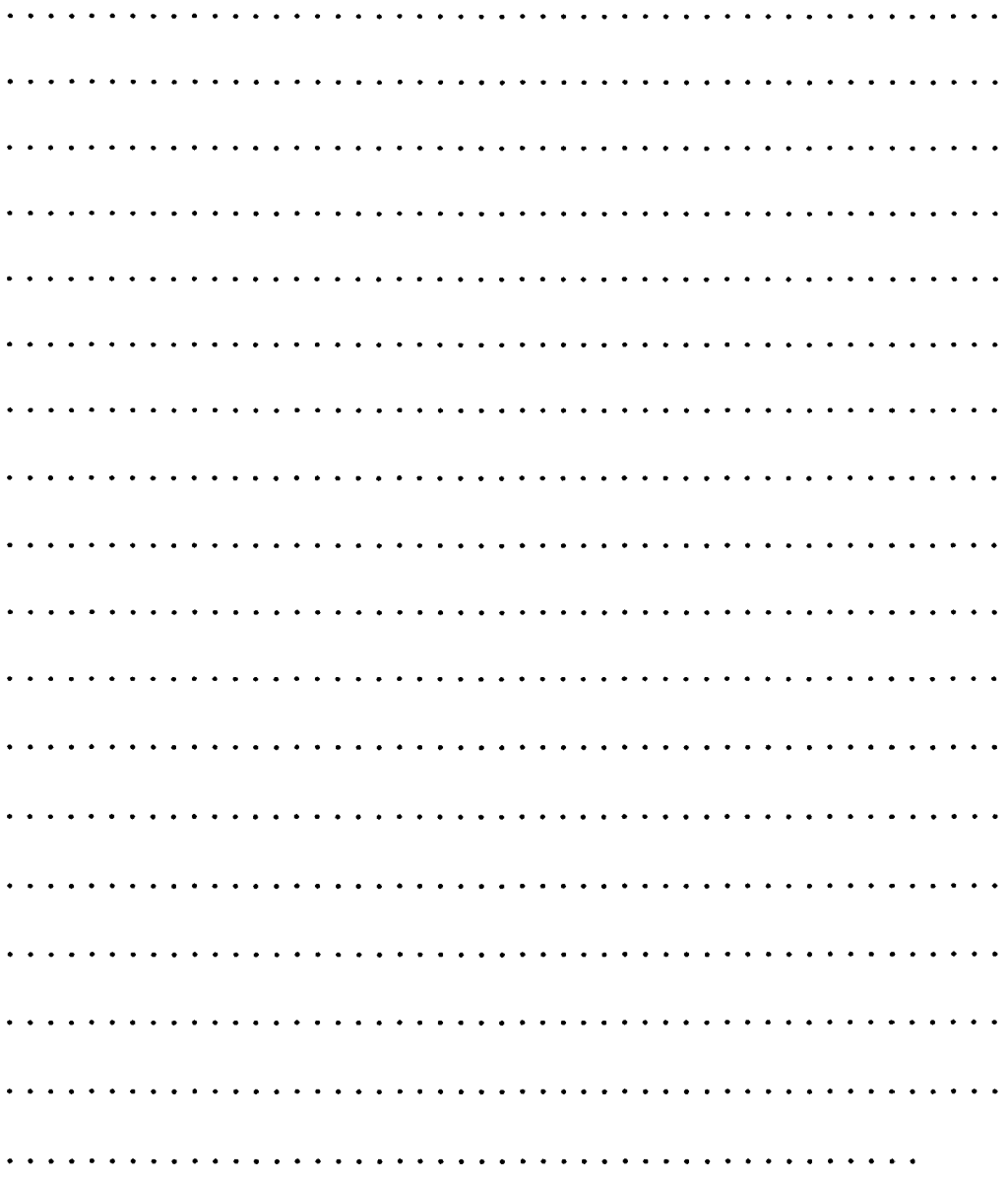
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10- آیا برای مدرن سازی صنعت نفت و گاز کشور يك چارچوب مشخص طراحی شده است؟

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## ENGLISH TRANSLATION

### Interview Questions

#### **Background to the privatisation policy:**

- 1) Were there differences of opinion between the team in charge of the practical drafting the law and the Cabinet? If yes, on what issues?
- 2) Does the privatisation framework favour a particular social, economic, political, etc. group? Does it make clear distinction between domestic and foreign capital?

#### **Legal framework**

- 3) What are the main areas allowing for discretion of key institutions and officials in charge of carrying out the privatisation programme? Please give examples. How has this discretion been exercised and to whose benefit?

## **Implementation**

4) What is the level of political control and interference in the privatisation process? Are there concrete examples of how this was done in practice?

5) Are there detailed criteria that have to be met for the privatisation deal to be approved?

## **Public perceptions of privatisation**

6) In your opinion, to what extent privatisation was something of importance to local people?

## **Political Influence**

- 7) Has the direction of the privatisation programme changed with changes in government?
  
  
  
  
  
  
  
  
  
  
- 8) Is there any political purpose performed by the oil and gas sectors, i.e. is it a politically intensive industry in the sense that the way it is being regulated creates dis/advantages for different political parties?

## **The Oil and Gas Sector**

- 9) Has the legal and institutional framework been devised to account for substantial privatisation in the oil and gas industry?
  
  
  
  
  
  
  
  
  
  
- 10) Has a framework been devised to account for modernisation in the oil and gas industry?

**APPENDIX IV:**  
**LIST OF INTERVIEWEES**

Mr. Gholam Hassan Abiri, Lecturer, MPO and Tehran University, Applied Economics Research, Tehran, 19 December 2005.

Professor Hossein Afarideh, MP, Member of the Committee for Energy at Majlis, Deputy to Iran's Head of Nuclear Agency, 24 December 2006.

Dr. Parviz Aghili, Managing Director, Karafarin Bank, Tehran, 29 December 2005.

Mr. Hossein Kazempour Ardebili, Deputy Minister of Petroleum/Head of Iran delegation to OPEC, Member of NIOC Board of Directors and Chairman of NICO. Interview took place at the ministry HQ on 26 December 2005 (also called into the meeting: Mr. Mohammad Alipour-Jeddi, Head Petroleum Market Analysis Dept., OPEC, Austria.

Dr. Mehdi Assali, President, Institute for International Energy Studies (IIES), Tehran, 19 December 2005.

Dr. Mehdi M. Behkish, Secretary General, Int'l Chamber of Commerce-Iran, and Associate Professor in Economics, 18 December 2005.

Dr. Bijan Bidabadi, Faculty Member & Director of Foreign Exchange Research Department of Central Bank of Iran, 28 December 2005.

Engineer Kamal Daneshyar, MP, Head of Energy Commission, Majlis, 24 December 2005.

Dr. H. Ghanimi Fard, Executive Director, International Affairs, NIOC Petroleum Ministry HQ, Tehran, 22 December 2005.

Dr. Narsi Ghorban, Managing Director, NarKangan (NGTLC) Gas to Liquid Int'l Co., Tehran, 18 December 2005.

Dr. Ali Hamadani, Legal Advisor, Society for Industrial Management, Tehran, 17 December 2005.

Engr. Mohamed Hossein Nejad Hosseinian, Deputy Minister of Petroleum, International Affairs, Tehran, 18 December 2005.

Mr. Ali Khorram (former Ambassador to China), Deputy, High Council of Free Trade - Industrial Zones Secretariat, Tehran, 17 December 2005.

Mr. Hassan Khoshpour, Deputy Economic Affairs/Privatisation, Management and Planning Organisation (MPO), 26 December 2005.

Dr. Akbar Komijani, Vice Governor, Economic Directorate, The Central Bank of Iran, 25 December 2005.

Mr. Hassan Lajevardi, Lecturer and, Deputy Director Econ. Research, Centre for Energy Studies-MATN, Tehran, 20 December 2005.

Mr. Saeed Leylaz, Vice President-Sales and Marketing, Iran Khodro Diesel Co. Plc., 19 December 2005 at their HQ.

Dr. Abbas Maleki, Chairman, International Institute for Caspian Studies, Tehran, 24 December 2005.

Mr. Hossein Mamdooh, Member of Board of Directors, Iran Helicopter Services Company (IHC) and Head of Quality Assurance, Tehran, 22 December 2005.

Dr. Alinaghi Mashayekhi, Economics Dept., Sharif Technical University, 24 December 2005.

Mr. Houshang Naderian, Chairman & Managing Director, Audit Organization, Tehran, 22 December 2005.

Mr. Iraj Nadimi, MP / Deputy Head of Majlis Economic Committee, and University Lecturer, Tehran, 24 December 2005.

Dr. Massoud Nily, Head of Economics Dept., Sharif University, 31 December 2005.

Dr. Ebrahim Razaghi, Professor of Economics, Tehran University, Tehran, 26 December 2005.

Dr. Mehdi Sadeghi, Alameh University, Economics Dept., 28 December 2005.

Dr. Sohrab Shahabi, Deputy Secretary General, Economic Cooperation Organization and University Lecturer (interview conducted in Tehran), 27 December 2005.

## **APPENDIX V:**

### **LIST OF RESPONDENTS TO THE QUESTIONNAIRES**

Dr. Abolghassem Hashemi, Associate Professor of Economics, Dept. of Economics, Shahid Beheshti University, 30 December 2005 (this form was filled out during a personal interview).

Dr. Parviz Aghili, Managing Director, Karafarin Bank (first private bank in Iran), Questionnaire form was later used in the personal semi-structured interview of 29 December 2005.

Mr. Hossein Mamdooh, Member of Board of Directors, Iran Helicopter Services Company (IHC) a company owned by NIOC and singled out for privatisation, and Head of Quality Assurance, December 2005.

Mr. Houshang Naderian, Chairman & Managing Director, Audit Organization, December 2005, very kindly filled out the questionnaire whilst also agreeing that I carry out the semi-structured interview with him as well (was appointed by the government to check the accounts and audit approximately 2000 government companies).

## APPENDIX VI:

### EXAMPLE OF TYPICAL WRITTEN RESPONSE TO QUESTIONNAIRE

#### Questionnaire on privatisation in Iran:

*Mr. Houshang Naderian, Chairman & Managing Director, Audit Organization, Dec. 2005, very kindly filled out the questionnaire whilst also agreeing that I carry out the semi-structured interview with him, as well.*

*(Was appointed by the government to check the accounts and audit roughly 2000 government companies)*

#### **Background to the privatisation policy:**

- 1) What have been the main debates leading up to the formulation of the Iranian privatisation policy? At least three categories of debates must be analysed: academic, political, economic?

*Economic - lack of proper management, functionality of the companies, together with lack of profitability of the government companies.*

*Political – Volume and the size of the government companies and their interaction with the people.*

*Academic/Theoretical – Government(s) is and has never been a good business person. To get involved in entrepreneurial endeavours for the government companies, is a mistake.*

- 2) Were there differences of opinion between the team in charge of the practical drafting the law and the Cabinet? If yes, on what issues?

*No, I think there is harmony and consensus amongst the political elite. The differences are usually pronounced in some using privatisation as a tool to balance their yearly budgets, whilst others think of it as the engine for economic progress and development. These two differing opinions are probably still in place. Compounded with this dilemma, one could also mention that some middle management people feel that the loss of the companies under their jurisdiction, means loss of power and their old power base.*



- 3) What was the profile of the expert group in charge of drafting the privatisation law?

*Generally this issue is dealt with by the experts within the Management and Planning Organisation (MPO) and then after its approval by the Cabinet, it goes to the Majlis for ratification. The Edicts from the Expediency Council (EC) are investigated and researched by the economic experts within the government and EC before it is handed over to the Privatisation Organisation, for their implementation.*

- 4) Which actors (politicians, religious elite, interest groups, formal and informal associations, etc.) were most involved and put most weight in drafting the initial privatisation legislation and its subsequent by-laws and amendments?

*The Government (Ministry of Economy and Finance, MPO), in consort with the economic commission within the Expediency Council.*

- 5) Does the privatisation framework favour a particular social, economic, political, etc. group? Does it make clear distinction between domestic and foreign capital?

*No it was not drafted to favour a particular group, however, the deprived sections and people of the society will get some priority in the implementations phase, in purchasing the shares. Naturally there is a distinction between domestic and foreign capital in that, priority is given to domestic investors.*

- 6) Why so much time elapsed between 1995 (when the privatisation programme of Iran was officially inaugurated) and 2000 (when the Third Plan actually codified procedures and institutions)? What are the reasons for this delay?

- A) *Lack of a well thought of, appropriate macro planning*
- B) *Lack of supervision and controls from Majlis*
- C) *Reluctance and resistance by mid-management*
- D) *Complex and burdensome bureaucracy within the government sector*

- 7) In those five years who were the most active actors in pushing for the actual privatisation codification and the go-ahead for the Iranian privatisation programme by the Third Plan?

*The Government (Ministry of Economy and Finance, MPO), in consort with the economic commission within the Expediency Council.*

## Legal Framework

- 8) Did the privatisation legislation regulate the most important issues? If not, what were the areas that were insufficiently regulated or omitted altogether? How did this change at later stages?

*The areas needing modification and requires correction are: The Privatisation Laws, Appropriate Planning, Political Will of the executors, All encompassing supervision by Majlis, and, a concerted effort in trying to simplify the regulations and the laws governing privatisation. All these matters can be addressed, if the political elite, will this to move forward.*

- 9) Consistency of legislation: are the by-laws decreed subsequently by the Cabinet in accordance with the general framework set out in the Third Plan? Who were the initiators and the most influential actors in devising the by-laws?

*None of the targets have been met over the last 15 years. The main problem has been the slow pace with which the executive body has been able to propel this issue forward.*

- 10) What are the main areas allowing for discretion of key institutions and officials in charge of carrying out the privatisation programme? Please give examples. How has this discretion been exercised and to whose benefit?

*In the past, the Supreme Privatisation Council, which consists of a mix of government executives, using the Privatisation Organisation, to implement their plans. Since not much has been done, once can not say that there were any discretion.*

- 11) Within the legislative and institutional set-up which has come to be the central and most influential institutional actor? Why?

*The Privatisation Organisation, MPO (management and planning organization), and the Ministry of Finance & Economy. These same organizations play a major role in the Supreme Privatisation Council, which includes many of the decision makers from within these organizations, which in turn, executes their plans through the Privatisation Organisation.*

## Implementation

- 12) What is the level of political control and interference in the privatisation process? Are there concrete examples of how this was done in practice?

*I do not believe there has been an effective control mechanism. The slow pace and the statistics we have confirms the lack of positive controls.*

- 13) Methods of privatisation: who is in charge of selecting among various privatisation methods? Which ones are the most frequent types used? What are the most common types of preferences and closures?

*I can answer the first part of your question by repeating what I said earlier in question 11 ie: The Privatisation Organisation, MPO (management and planning organization), and the Ministry of Finance & Economy. These same organizations play a major role in the Supreme Privatisation Council, which includes many of the decision makers from within these organizations, which in turn, executes their plans through the Privatisation Organisation.*

*To answer the second part of your question, I should say the method by which one audits the assets of the targeted organization, would be preferred.*

- 14) Who is responsible for evaluating assets of companies slated for privatisation?  
How has this been done?

*The Privatisation Organisation. It provides the information, and the documentation collected from the relevant government ministry/body. The auditing of its value is conducted by independent accountancy and auditing firms/bodies/organizations.*

- 15) Are there detailed criteria that have to be met for the privatisation deal to be approved?

*As a general rule, there are no detailed criteria, however, the preferred method by which the companies are privatised is through auction, and in some cases by IPO,s through the Tehran Stock Exchange (Bourse).*

- 16) What was the most common form of breaching the legislation on privatisation?  
How are such cases dealt with?

*In the first instance, not meeting the targeted budgets and or privatisation plans. In the second part of your question, I must say, we have not seen any cases in which the government has dealt with such anomalies.*

- 17) What is the practical impact of the relationship between enhancing economic efficiency and privatisation, which is clearly stated in the laws and regulations?

*With privatisation in place, the entity will operate with a profit motivation and with view that it must compete fairly and head on. This phenomenon will improve the profitability of the entity and hence will benefit the workers and the shareholders alike. Furthermore, this will reduce the size and the burdens of the government enabling it to regulate and supervise the activities, to everyone's benefit.*

## **Outcomes and Follow-up**

18) Who are currently the main winners and losers from the privatisation process?

*In view of the slow pace with which we have moved towards privatisation, there are no winners. The losers have been the government and the population at large, which still has to carry the burden of running a non competitive and non profitable companies.*

## **Public Perceptions of Privatisation**

19) In your opinion, to what extent privatisation was something of importance to local people?

*The masses, ie: blue collar workers, farmers, and generally the common people, are not too bothered by this concept. The Academics, Management people, Upper Middle Classes with knowledge of economic issues, this concept is considered to be very important.*

20) Do you believe that this has changed during the past ten years?

*No. I don't believe so.*

## **Political Influence**

21) Has the direction of the privatisation programme changed with changes in government?

*The direction has not changed, however, the pace has changed from time to time.*

22) Is there any political purpose performed by the oil and gas sectors, i.e. is it a politically intensive industry in the sense that the way it is being regulated creates dis/advantages for different political parties?

*No.*

## The Oil and Gas Sector

23) How much has been already deregulated in the Iranian oil and gas sector?

*Not much. At least, not to a tangible or a perceptible degree.*

24) What trend do statistics reveal, i.e. in which direction is Iran moving – a global strategy for the whole sector or compartmentalising it and deciding different strategies for each separate area?

*Compartmentalising it and deciding different strategies for each separate area, using the experience of other countries.*

25) Has the legal and institutional framework been devised to account for substantial privatisation in the oil and gas industry?

*No. It is the same here as in other sectors.*

26) Has a framework been devised to account for modernisation in the oil and gas industry?

*A 20 year" vision plan" has been drawn up. But nothing tangible has been propagated.*

**APPENDIX VII:**  
**EXAMPLE OF TYPICAL RESPONSE**  
**TO INTERVIEW QUESTIONS**

**Interview Questions**

*Dr. Bijan Bidabadi, Faculty Member & Director of Foreign Exchange Research  
Department of Central Bank of Iran. Interview 28 December 2005.*

**Background to the privatisation policy:**

- 1) Were there differences of opinion between the team in charge of the practical drafting the law and the Cabinet? If yes, on what issues?

*Privatisation has been discussed and has been mentioned from inception of the Five Year Development Plans (FYDP). Particular attention has been put on Privatisation issues in FYDPs of 2, 3, and 4. The government, otherwise, the executive branch, and the Majlis has been favourable towards privatisation, however some interested parties try to create stumbling blocks. The reason for this is that the government (Executive Branch) does not possess the powers of a sovereign country. These are given to the Expediency Council, the Council of the Guardians, and the Spiritual Leader.*

- 2) Does the privatisation framework favour a particular social, economic, political, etc. group? Does it make clear distinction between domestic and foreign capital?

*The framework which has been revamped during the 3<sup>rd</sup> and 4<sup>th</sup> FYDP, does not favour any particular group. In implementation, we have seen lobbying and jockeying for position by people close to the political elite.*

*There is a distinction between domestic and foreign capital, however, foreigners could use some of the recent ratifications in laws, to own 100% of the stocks of an Iranian Company.*

## **Legal framework**

- 3) What are the main areas allowing for discretion of key institutions and officials in charge of carrying out the privatisation programme? Please give examples. How has this discretion been exercised and to whose benefit?

*The Privatisation Organisation has been tasked with the implementation of the privatisation programme, within the defined laws passed by the Majlis. It can decide on the priority of which company to be sold off first, or if it wishes, to stop from going forward the sale of a particular company pegged to be privatised.*

## **Implementation**

- 4) What is the level of political control and interference in the privatisation process? Are there concrete examples of how this was done in practice?

*If by this we mean the lobbying behind the scenes or overtly, yes there are political interferences. Furthermore, due to weak management in execution of the original privatised companies, no one wishes to stick their necks out. They do not wish to be singled out for making decisions, hence, decisions are made in committees and this takes way too much time. The delays, offer an opportunity for the lobbyists to interfere and or change the course of the plans being discussed or being implemented.*

- 5) Are there detailed criteria that have to be met for the privatisation deal to be approved?

*The privatisation laws have detailed criterion. For instance there are sections dealing with loss making SOEs and or security issues are areas that are focused on diligently.*

## **Public perceptions of privatisation**

- 6) In your opinion, to what extent privatisation was something of importance to local people?

*Unfortunately, the masses are sceptical about the government's true intentions. They know there could be changes to reverse everything or undo what has taken place. The public at large, do not have a favourable impression or faith in what the government wishes to carry out.*

## **Political Influence**

- 7) Has the direction of the privatisation programme changed with changes in government?

*In Iran, unlike the western democracies, the direction of the programs/policies do not change. It is the governments which tries to synchronize itself with the new policies.*

- 8) Is there any political purpose performed by the oil and gas sectors, i.e. is it a politically intensive industry in the sense that the way it is being regulated creates dis/advantages for different political parties?

*Not only the industry is highly politicised, but also, all activities which support or somehow is collaborating with this industry, belong to an 'invisible network'.*

## **The Oil and Gas Sector**

- 9) Has the legal and institutional framework been devised to account for substantial privatisation in the oil and gas industry?

*Due to the volume of income derived from this industry, the interested parties and the 'invisible hands behind this industry' will stop any attempt at transparency or change in the nature of its policies.*

- 10) Has a framework been devised to account for modernisation in the oil and gas industry?

*No. I don't think in the short term, there are any such plans in place. This could only happen when the current management and their political backers and supporters are set aside. The current management follows a 'gently gently' approach, so that it will not offend anyone.*



theoretical and practical, with the impact of and challenges posed by this 'new' macroeconomic recipe. The British experience stood out particularly, and was used by many scholars and professionals as the paradigmatic example from which to draw both positive and negative lessons.

Whitehead (1988) provided one of the earlier accounts of the British shift towards privatisation. The author's verdict regarding the British government's initiatives is positive overall. However, she also recognises that only the easier parts of the adjustment measures had so far been implemented. Along with privatisation, the introduction of competition to markets which had been previously restricted and a firmer control on the management of the companies whose ownership remained in public hands, were the kind of initiatives taken by the British government in order to enhance the efficiency of the industries and their markets. Within the energy sector, it is argued that the case of British Gas was one of the less glorified examples of privatisation; the 1986 Gas Act being merely a transfer of a monopoly from public to private hands. Veljanovski (1989:28) argues that:

The challenge for policy makers over the next decade or two will be to examine the mistakes which have been made in privatising the utility industries and how to foster more competition and less regulation.

The key sectors that were the object of the British privatisation programme (communications, energy and transport) are covered.

Vickers and Yarrow (1989) cover both theory and facts in their analysis of the British privatisation programme. The authors discuss the evolution of the programme within different industrial and service sectors: from the more spectacular cases of the sale of British Telecom and British Gas, which proved less successful in the end, to the privatisation of Cable and Wireless, Jaguar and other companies, which were potentially more prone to competition to begin with and therefore offered more positive results

according to the authors' primary criterion of judgement; that is, the improvement of industrial efficiency. What also becomes clear in tracing the evolution of the British privatisation programme is that the 'learning by error' maxim also applied to the British administration.

Ghobadian *et al.* (1998) evaluate the applicability of the Miles and Snow typology to the electricity distribution and supply industry of England and Wales in the late 1990s. They consider that the Miles and Snow approach focuses on the adaptive cycle of industries in which major changes occur. The authors assess the largely advocated benefits of privatisation on business performance in the context of the takeover of the U.K. electricity industry by American utility companies between 1995-1998. The takeover itself is discussed by Ghobadian and Viney (2000).

Bishop *et al.* (1994) are aware that the UK privatisation programme has had considerable influence on economic policy throughout the world and their purpose was, consequently, to stand back and examine what has been learnt from this extensive programme. According to the authors, there are three factors that can justify privatisation: finance (state revenues), information (bureaucratic transparency) and control (decreasing public control). On finance, it is argued that privatisation has only modest effects. On information, it is suggested that the 'free rider' problems in information collection in financial markets are serious. On control, the authors argue that there has clearly been a weakening of control exerted by the government. Finally, the authors argue that privatisation has also helped to rebalance the control between trade unions and management.

Stevens (2004) views privatisation as the persistent legacy of the political economy of Thatcherism, although from an historical point of view. He claims that privatisation developed an important electoral dimension during the second Thatcher government (Stevens, 2004), a point which does not often come up in the studies of economists and political scientists. Essentially, Stevens argues it was the prominence of private

ownership in Conservative philosophy that allowed Mrs Thatcher to legitimise and defend privatisation before the electorate.

To summarise, there is abundant literature on the British privatisation programme, which approaches the topic and evaluates the outcome slightly differently. There seems to be an overall agreement, however, that the British experience was, in many ways, groundbreaking.

#### *1.1.1.2 International Examples*

The relevance of the British experience seems clear. But what about other countries which also began to experiment with the privatisation formula? Butler (1992) provides an interesting account of the aims of privatisation, the nature of the process and a number of relevant international experiences of privatisation. According to Pirie (1988), there are ten objectives of privatisation: lowering costs, depoliticising decisions, better service quality, better management, better labour relations, wider share ownership, restoring profitability, replacing capital, competition and choice and, finally, keener prices. Cook and Kirkpatrick's (1995) interesting book includes contributions from international scholars and professional economists. It looks first at transitional and European countries, then at developing countries, covering a range of countries in the five continents. The editors suggest that the policy objectives and motives for privatisation vary between countries. In industrialised countries, the main motive turns out to be ideological, whereas for developing countries, privatisation is linked with the macroeconomic burden of the public enterprise sector. Moreover, the early notion that privatisation would be a panacea for major structural imbalances and economic discontent was due, in part, to the tendency to understand privatisation as synonymous of economic liberalisation, instead of seeing it as just one ingredient in a wider programme of economic policy reform.

Hossain and Malbon (1998) are concerned with who actually gains with corporatisation and privatisation. Drawing from experiences of privatisation in the 1990s in New Zealand, Australia, the UK, the US, Sweden, Malaysia and India, the contributing researchers in this edited study provide theoretical insights and reflections on the reasons for and against privatisation. The underlying goal is to warn against extreme positions of either dismissal or glorification of the two decades of privatisation initiatives. There might be a danger in:

...following the models of those societies which have in fact introduced a feverish degree of market competition within their own countries but have failed in the international competition on which those companies and ultimately their people depend (Hossain and Malbon, 1998:262).

It is also suggested that the success of the British model of privatisation has been clearly overestimated and should actually rather be seen as a warning sign.

Whether the British model has been idealised or not, Basu (1994) is concerned with the mystique of privatisation in developing countries where it is often viewed as an imposition coming from the International Monetary Fund (IMF) and World Bank. There are several misconceptions underlying this mystique, he argues, like the idea that privatisation removes all state-run welfare activities. At the same time, successful privatisation involves complementary strategies of public sector restructuring, reform-cum-commercialisation, training and cadre development as well as private sector development with financial sector strengthening (Basu, 1994).

The attempt to grasp the advantages and disadvantages of privatisation is also considered by Prizzia (2001), who provides a comparative critical assessment of a number of relevant experiences of privatisation worldwide. He suggests that, up to now, the economic benefits of privatisation activities are on average modest, while the social benefits are often mixed and uneven (Prizzia, 2001). The challenge for future

privatisation programmes should be to balance economic and social performance in a way that assures long-term benefits for all sectors of the affected communities.

Banerjee and Munger (2004) offer another, more recent, interesting comparative study of privatisation in 35 low or middle-income developing countries. Through a rigorous analysis of data they attempt to explain the essential political-economic interactions affecting privatisation decisions and find, for example, that early adopters of privatisation tend to be later implementers, and that privatisation policy is much more likely to be a crisis-driven, last ditch effort to turn the economy around, rather than a carefully chosen policy with explicit, long-term goals (Banerjee and Munger, 2004).

Further international insights are provided by Ramanadham (1994), who focuses on the aftermath of privatisation. The book is one of a series of studies undertaken by the Interregional Network of Privatisation, established by the UNDP's Division for Global and Interregional Programmes.<sup>118</sup> Various scholars highlight the monitoring and regulatory aspects of privatisation in Pakistan, Sri Lanka, Nigeria, Guyana, Argentina and in five former centrally-planned economies. Ramanadham (1994) suggests that governments may not have yet appreciated the importance of monitoring privatisation, but should be aware that the benefits far outweigh any possible damage through self-exposure. Amongst other things, he recommends that the nature of the agencies to be entrusted with monitoring ought to be country-specific and implies that the substantive area to bring under monitoring may be expanded over time. He also makes the point that privatisation in developing countries and in centrally-planned economies in transition takes many years to accomplish. Finally, monitoring, it is argued, should not be confused with either regulation or evaluation - monitoring implies a close observation over the implementation of a programme or activity; that is, over the process itself and not merely its final outcome.

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<sup>118</sup> UNDP = United Nations Development Programme.

### ***1.1.2 Key Literature on Reforms and Privatisation in Developing Economies and Formerly Centrally-planned Economies***

There appears to be a need to distinguish between developed, developing and formerly centrally-planned economies to be able to assess the different experiences of privatisation. Chandra (1992) provides a good overview of developing economies, helping the reader to better understand their possibilities and challenges. The book covers fairly standard topics which range from the historical dimensions of Third World industrialisation, its level and structure, the organisation and location of manufacturing in Third World countries, through to the role of the state in the industrialisation processes. According to Chandra, a central issue in development studies is the fact that there is only one world system, which means that what happens in one part of the world eventually impacts on other parts. Therefore, he argues “the future industrial prospects of developing countries depend both on the domestic policies and the international economic environment” (1992:14). Chandra’s recipe for domestic policies for bettering the industrial sector follows mainstream development scholarship, and includes clarity (in the formulation of such policies), stability, social consensus among the different economic actors, a commitment to competition in the manufacturing sector, and the reduction of regional, social and ethnic inequalities.

O’Neill (2004) delves into the history and pros and cons of globalisation. His argument is very much informed by his position as a business leader and scholar, maintaining that globalisation has improved the economic welfare of both rich and poor nations and, moreover, that the macroeconomic impacts of globalisation (basically on inflation and employment) are very limited.

A more nuanced view, perhaps, is offered by Abu Shair (1997), who tries to bring together privatisation and development through a case study of privatisation in Jordan. His aim is to provide a different view of privatisation as a way of enhancing human

capabilities and choices (Abu Shair, 1997) instead of merely considering its effects on efficiency and economic growth which most conventional studies do. Abu Shair argues that where privatisation is linked to participation, decentralisation and development, there emerge actual opportunities to increase people's choices and capabilities.

The Arab-British Chamber of Commerce (1990) provides another comparative perspective in a short but insightful survey of privatisation policies and instruments in the industrial, developing and Arab countries. The role of the World Bank and IMF as major promoters of privatisation since the late 1980s is particularly emphasised. For many developing countries, privatisation becomes a chance to solve the external debt problem. As for the Arab countries, it is argued that their stances towards privatisation vary considerably, but that they are in no sense immune to the world move towards privatisation.

Economic reforms in formerly centrally-planned economies are of particular interest to an increasing number of scholars. One of the earliest assessments of these reforms is by Blanchard *et al.* (1991). The pace of events in Eastern Europe in the early 1990s caught the attention of this group of renowned scholars and challenged them to tackle the main issues involved in the reforms. The authors argue, in the end, that stabilisation, price liberalisation and privatisation must occur fast, whereas restructuring will take longer: a decade or more. Their proposals for stabilisation draw extensively on Latin American experiences. Their proposals for privatisation, on the other hand, are sustained on the principles of fairness and efficiency. The result of their contributions is a compact and well-outlined book, written, it should be kept in mind, at the beginning of the Eastern European transition to a market economy.

An equally early viewpoint on the transition of the former communist countries to a market economy is offered by Bird (1992). The nine contributors reflect on different aspects of the economic reforms in Eastern Europe, arguing that the challenges to a properly functioning market economy in these countries may have been initially

underestimated. The tension between going too fast and engaging in too comprehensive reforms that may become unmanageable, on the one hand, and going too slowly and therefore not producing results immediately enough, which tends to generate discontent among different social groups, on the other, seems to define the general scenario in which Eastern European countries found themselves in the 1990s. Among the contributions, there is a chapter devoted to the reform in Hungary, which discusses the challenges of sequencing and privatisation. In this, Newbery begins the discussion by asking which is the desirable sequencing of demonopolisation, liberalising domestic markets and liberalising trade (Newbery, 1992). The Polish example would be one in which market liberalisation preceded demonopolisation, whereas the Hungarian and the (at that time) Czechoslovakian programmes started with demonopolisation. However, Newbery carefully insists that the problem is in no way simple. He therefore proceeds to analyse the country-specific economic and financial constraints that may lead to a particular choice of sequencing, as well as the outcomes of these different choices. He concludes by emphasising the role of demonopolisation and claims that its urgency depends on the speed of liberalisation and the form of privatisation.

A more recent study of the transition economies is provided by Professor Goldman (Director of the Davis Center for Russian and Eurasian Studies at Harvard University), who specifically investigated the Russian situation. Goldman (2003) provides a detailed account of how a few individuals, namely seven, turned the collapse of the Soviet economy in the early 1990s into an opportunity for amassing immense private wealth over the span of a few years. According to Goldman, this was possible thanks to the lack of policy control and, sometimes, also the complicity of politicians and certain groups within the government and administration. Furthermore, he argues, the problems of corruption and the emergence of mafias in Russia are partly the result of the way in which the economic reforms were tackled from the start; for instance, the absence of adequate timing and the ease and speed with which old and new interest groups consolidated.



Marangos (2002) analyses the neoclassical privatisation policies implemented in transition economies from a post-Keynesian point of view. According to him, the neoclassical privatisation policies contributed to a large reduction in output, high unemployment and inflation, as well as a breakdown of legality leading to corruption. The social cost of privatisation would have been smaller if post-Keynesian principles, such as the free distribution of shares to workers and the establishment of labour managed firms, had been followed.

A brighter perspective is provided by Hanousek and Kocenda (2003), who analyse the privatisation process in the Czech Republic. Although they recognise that they still lack sufficient data, they are able to make the claim that the improvement in profitability of the enterprises they surveyed was due to improvement in corporate governance.

It appears from the literature on economic reform and privatisation in developing and former centrally-planned economies that there are multiple views on these issues. Since these economies are particularly vulnerable, the advantages and disadvantages of privatisation become perhaps more visible in their context.

Whilst much effort has been put into removing the paradoxes in article 44 of the Iranian Constitutional Law and thereby demonstrating the political will among the leadership in Iran for pushing through with the privatisation programme, we have seen more government entities register in 2005 and 2006 compared to those which were privatised.

Dr. Mohamad Hadi Zahedivafa, the Deputy Minister of Economy in President Ahmadinejad's government, in charge of economic affairs, believes<sup>119</sup> that the most challenging issue slowing down the privatisation drive is not the lack of political will among the elite in the country, but the lack of financial institutions with appropriate

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<sup>119</sup> Personal interview 12 January 2007, Tehran, Iran.

regulations, liquidity in society and the restrictions on foreign ownership of the shares to be offered through the Tehran Stock Market.

Ayatollah Khamenei, the spiritual leader, expressed his concerns and dismay at the lack of any tangible progress in the privatisation of government entities in early February 2007. Ahmadinejad's government and the media have been hard at work trying to find out what obstacles have been instrumental in slowing down the plans for privatisation of the nationalised industries. On 21 February 2007, the Bill for privatisation of government entities was presented to parliament for ratification and, if need be, replacement of those by-laws which under clause 44 of the constitution are hindering the government. The new set of changes and amendments to the labour laws and foreign ownership should provide the government with the bases and necessary tools to meet their anticipated privatisation of 20% of the government's holdings per year.

### ***1.1.3 Key Literature on the Oil Industry and Privatisation of the Oil Sector***

This section is devoted to the evolution and challenges of the oil industry. Drollas and Greenman (1989) attempt to respond to an increasing public interest in the historical evolution of the oil industry in the aftermath of the oil crises in the 1970s by addressing some of the most basic conundrums. How were the sudden increases in oil prices ultimately possible? Were they solely contingent upon the political turmoil that took place in the Middle East in the mid- and late 1970s? Or were they due to a sudden global realisation that oil was a scarce resource? Why did the prices remain at those historically high levels? Their discussion on the myths and misunderstandings that historically unfolded among the different actors with an interest in the oil industry (basically the companies, states and consumers) which ultimately all derive from the contradictory nature of the oil phenomenon itself (oil being viewed as either 'the devil's gold' or 'the devil's excrement') are of particular interest.

Perhaps in contrast to Drollas and Greenman's more divulgation-oriented piece, Mitchell *et al.* (2001) offer a thorough and impressive piece on the current situation of the oil industry. One of the main ideas under discussion is that *acceptability* of oil is becoming more important than *availability*, as the oil industry faces the challenges posed by new patterns of transportation, increasing fuel demand in economically emergent regions and, at the same time, conflicting attitudes towards oil consumption.

A good way to approach the history of the oil industry and understand its gradually increasing importance for the world economy are two books depicting the history of the British Petroleum Company (Ferrier, 1982; Bamberg, 1994). The first book, *The Developing Years 1901-1932* (Ferrier, 1982), is devoted to the emergence and early days of the Anglo-Persian Oil Company (APOC), as it was called at the time. The timeframe encompasses the years that the D'Arcy concession was granted, up until the termination of the concession by the Iranian monarch, Reza Shah Pahlavi. In the later publication, *The History of the British Petroleum Company - The Anglo - Iranian years 1928-1954*, Bamberg discusses, among other things, the details of the D'Arcy concession and Burmah Oil's involvement when the company ran into difficulties. He is also particularly keen on explaining the reasons for, and procedures by which, the British government acquired a major interest in APOC, once the British navy converted from coal to oil in 1914. The Iranian government rejected the British offer to become a 'principal of participation' on the basis that a minority shareholding in APOC was contrary to their national sovereignty. Ferrier's (1982) account offers relevant insights into the roots of the problems that eventually led to the nationalisation of the oil industry in 1951.

Twelve years after the publication of Ferrier's account, the second book on the history of the British Petroleum Company came out (Bamberg, 1994). This is more orthodox in its structure, fundamentally providing an account of the company's affairs over time, a discussion of corporate development, particularly in the immediate post-war period, and a detailed description and analysis of the years of crisis between 1947 and 1954, when

APOC eventually became the British Petroleum Company. Both books constitute a must for anyone interested, not only in the history of the British Petroleum Company, but also in the general history of oil development and the economic history of the Middle East. Hoopes addresses the sale of Britain's oil assets, claiming that control of energy resources has traditionally been a source of power for states; yet the sale of Britain's oil assets, vital resources in an oil-dependent world, passed without much opposition or even much notice (Hoopes, 1997). She aims to explain why the government pursued this "seemingly irrational policy" (1997:188). Written from a public choice perspective, she comes to the conclusion that:

[a] government voluntarily relinquishing control of valuable national assets is not a rational act – at least when examined as a whole from the macro level. But when the act is broken down into pieces, and factors are isolated at different levels of analysis, the pieces of the process can be understood as rational (Hoopes, 1997:188).

Locatelli (1999) provides a rich description of the situation at the end of the 1990s. Amongst other things, he argues that the way in which the industry behaves is still regulated to a significant extent by planned economic relationships. On the other hand, he also claims that the 'survival' strategies are based on the willingness to maximise exports. There seems to be a compromise in Russia, which is summarised in the following equation: foreign currency in exchange for non-payments and for preserving jobs in the oil industry's holding companies.

From Russia, we move to the oil industry in the Gulf, which is key for obvious reasons. *Privatization and Deregulation in the Gulf Energy Sector* (ECSSR, 1999) is the result of contributions from practitioners and scholars who attended the Annual Energy Conference at the Emirates Center for Strategic Studies and Research held in Abu Dhabi in 1997 to discuss different micro- and macro-issues related to the privatisation and deregulation of the energy sector. Particular attention is devoted to the British experience as a leading example. The final chapter presents the pros and cons of

privatisation and deregulation of the energy sector in the Gulf Co-operation Council (GCC) countries. Their conclusion is that there is a potential for deregulation and privatisation of the energy sub-sectors (e.g., petroleum, power, water and gas) which would provide net gains to the economies of the GCC countries. Furthermore, the energy sub-sector is ready for privatisation. Sale of public sector petroleum enterprises downstream can be achieved in a relatively short period of time, as the local capabilities are well developed and operations under conditions dictated by the international markets are well established. Public sector power and water utilities in the GCC countries will require a relatively longer time. It is suggested that the development of the concept of BOO (Build-Own-Operate) for financing new investments could provide the bridging from public ownership to privatisation.

Privatization is expected to be implemented gradually and as part of a more comprehensive structural reform plan aimed at boosting non-oil sources of revenues and re-orienting the economies of the GCC countries from growth based on oil and public sector activities to one where the private sector takes the lead (Azzam, 1995).

Azzam (1995) goes through the objectives, concerns and mechanisms of privatisation, but with a particular emphasis on non-oil resources.

Even though Iran will be dealt with in detail from the historical and political aspects to a large extent in the next section and subsequent chapters, we will now turn to the Iranian oil industry by throwing some light on Iran's oil nationalisation and its aftermath (Elm, 1994). Elm's critical views on the British and the American governments' interventions in 1950s Iran are already present in the preface, where he overtly implies that the British Petroleum Company became a giant international corporation "at the expense of the producer country" (Elm, 1994:preface) i.e., Iran. This well-researched account follows a chronological order, which leads the reader through the intricate games of economic power that began among Iranian and colonial rulers in the late nineteenth century and continued in the twentieth consolidating the role of Iran as a major oil supplier and

hence a country in the eye of two of the main foreign powers in the region: Britain and the US. The emphasis of the book is on the period that runs between the Oil Nationalisation Act and the coup that reinstated the Shah.

Mitchell (2001), in his book entitled *The New Economy of Oil*, looks at the new elements which may influence, or indeed determine, the shape of the oil industry, the behaviour of the main actors, the forces of supply and demand, and the price path. In the foreword, Mabro questions if our world is subject to sudden and radical transformations. He questions whether historians always fully grasp the fact that change can be properly understood only in relation to continuities. He argues that most people focus on the novelty of an event, such as a revolution, only to be followed a few years later by a reformist who will stress continuities, arguing that nothing significant has occurred. The common thread in *The New Economy of Oil* is about a world where social acceptability is an increasingly important issue. For social acceptability to make a difference, it will have to acquire the momentum of a considerable political force, through development of a strong political will.

Amuzegar (1999) examines and evaluates the experience of thirteen OPEC members during the crucial 1974-1994 period. Within the framework of some major hypotheses regarding the dynamics of economic development in an oil-based economy, several fundamental questions are raised: how did the members allocate their oil windfalls among competing needs? What strategies and policies did they pursue in optimising returns on their fortunes during the oil boom, and controlling the damage during the oil bust? And, to what extent did those allocations and strategies help them achieve their stated or implied national socioeconomic agenda? It is with this in mind that Amuzegar discusses OPEC members' underlying national characteristics and structural differences in order to show how their astonishingly similar experiences defied such divergences.

Privatisation in Britain has been heralded by British politicians, the press and political observers alike as a radical break in government policy – not only for the British

government, but for any government. Hoopes (1997) attempts to explain how a major part of the British government's sales of its oil assets were conducted and how Britoil, Enterprise Oil, Wytch Farm and a majority shareholding in British Petroleum were sold within a ten year period (1977-87) without much opposition or even much notice, reversing a policy which had lasted 73 years.

Parra (2005) considers the politics of oil and illuminates how it revolves around its price and the reliability of its suppliers. He explains the historical background to the formation of OPEC and delves into the reasons for widespread international tensions and armed conflicts which he believes are the root causes for the tensions between the seven major oil companies who control the technology, distribution and marketing. Parra asks, taking into account the current political volatility in the Middle East, whether the major oil companies and their respective countries in the West can avert a deepening of the crisis.

Bahgat (2003) examines the US's growing dependence on fossil fuels and the main challenges it faces in securing supplies from two energy-rich regions, the Persian Gulf and Caspian Sea. He argues that long-term US energy strategy must be built on diversity of both the fuel mix and the geographical origin of that fuel. Bahgat does contend, however, that the goal should not be energy dependence on oil supplies from abroad.

Finally, Ala's (2000) discussion on the privatisation of NIOC at the 75<sup>th</sup> British Iranian Business Association (BIBA) Business Meeting in 2000 concludes by stating, among other things, that:

Iran can gain access to [world wide capital] for the development of its oil and gas related industries by improving its image and softening its political stance on the world stage... The NIOC must follow consistent, long term and commercially viable objectives and avoid half-hearted measures and sudden policy changes (Ala, 2000).

#### **1.1.4 *Key Literature on the Politics and Economy of the Middle East***

Before we look at the specific literature on Iran, we will refer to a few works on the general political and economical situation in the Middle East. Richards and Waterbury (1996) combine a political science and economics approach. They are interested in the interactive effects between economic growth and structural change, on the one hand, state agencies that implement policies, on the other, and the social groups (especially classes) that shape, and are shaped by, those policies. They argue that regime stability in the regions has systematically occurred at the cost of political exclusion, which has created a crisis of confidence. Furthermore, the authors discuss the material improvement in the region during the preceding four decades, acknowledging at the same time the common aspects that the Middle East shares with the rest of the developing world. They argue that there are some omissions in the work, like the lack of attention to regional conflict, political personalities and political culture. This is perhaps why the authors believe their work is useful as an analysis of Third World economies in general; they do not delve into the particularities of the region, but try to extract the structural features, making it comparable to other regions.

Despite certain practical difficulties in assessing the history of the Middle Eastern economies due to the lack of (sometimes) fundamental data, Owen and Pamuk (1998) provide an historical-economic account. Interestingly, they choose to locate the Middle East in the latest wave of globalisation. The authors base their inquiry on how the economies of the Middle East grew from the 1930s to the 1970s and why some economies grew faster than others. They examine the role of the state, and the impact of growth on society and its welfare. Lastly, the study looks at the impact of the 1970s' oil boom and the present process of liberalisation and structural adjustment.

The challenges, as well as opportunities, facing the Middle East and North Africa regions in the twenty-first century are the subject of analysis in the edited work by



Shafik (1998). The research work contributed to this book aims to answer some of the questions on why the region has not been able to introduce sufficient reform momentum to sustain economic growth, or what might be the social consequences of economic stagnation. The papers examine the vast opportunities facing the region, should the political elite and reformers exercise their political will in pursuing the structural adjustments necessary to bring about sustainable growth to their countries.

In another edited work from several researchers gathered in Cairo for a forum (Handousa, 1997), the papers presented attempt to draw upon economic, political and institutional theory in order to appraise and compare development models and apply new development concepts to the countries of the Middle East and North Africa (MENA). The contributing authors have addressed the key questions of globalisation, deregulation, privatisation and institutional reform.

Moreover, there are numerous pieces on the historical and political context of the Middle East. The following are but a selection of the literature available. Owen (2000), for example, traces the historical outline of the modern Middle Eastern states, beginning with the collapse of the Ottoman Empire and establishment of colonial institutions. Owen's comprehensive work focuses on the unfolding of the diverse institutional frameworks in the region, assuming the fluid, conflictive and evolving nature of political and social institutions and the particular situation of the Middle East as part of the global context of modernity, and yet situated in the Third World.

Armajani (1970) presents his work by going back to the advent and spread of Islam when developing his assessment of the cultural progression within Turkic, Persian and Arabic speaking countries of the Middle East. He then focuses on the Ottoman and Safavid empires to draw some lessons about the changes which took shape in the region. Lastly, Armajani looks at the effects of Western imperialism until the region was divided up into many nation states, as we know them now.

Bill and Springborg (1994) offer a comprehensive outlook on the contemporary political situation in the Middle East. Their work addresses, among other issues, the challenge of modernisation for political development, Islam and politics, leadership, the role of the military and the role of ideology.

Milton-Edwards (2000) explores the pace with which developments in Middle Eastern countries have taken place, keeping societal developments and changes in the forefront of their focus. Some of these issues with particularly remarkable insight with regard to the politics of gender and ethnic rights in the region, and the increasing presence of political Islam.

Niblock and Murphy (1993) have put together an impressive list of contributors in their seminal edited anthology that covers various aspects of economic liberalisation and walks us through to international integration. Their work explores everything from the links between economic and political liberalisation to individual analysis of the privatisation experience in some of the countries of the Middle East and North Africa.

Henry and Springborg (2001), in their research on the effects of globalisation in the twenty-first century in the Middle East, investigate how the merits of colonialism in the past have been superseded by a phenomenon now pursued under the auspices of economic globalisation. In their book, they have attempted to throw light on how globalisation has induced the countries in the region to move further towards democratisation. They contend that those countries who have moved further towards democratising have also been more effective in responding to globalisation.

Finally, Zahlan (1998) narrows down the geographical scope, analysing the political history of various Gulf states. She provides an insightful examination of the evolution of these countries, which is characterised in many ways by the contradictory pattern of economic globalisation and political traditionalism in the Arabian peninsula.

### **1.1.5 *Key Literature on the Politics and Economy of Iran***

The authors reviewed in this section discuss the contemporary social and political situation of Iran, the position of Iran in the world, and the economic situation of the country. Ansari focuses on the post-Khomeini era.

This is in essence a book about ideas, as espoused and traded by different political factions. Not only does it suggest a method by which to understand political developments in contemporary Iran, but it also seeks to explain how ideas operate to motivate and initiate political change in Iran (Ansari, 2000:2).

Ansari is interested in the dynamic qualities of social and political processes, and departs from the idea that Iran is an international player of a calibre that does not reflect either its economic or political strength. Again, the oil and gas resources account for this paradoxical situation, which does not make the Iranian case less fascinating.

Sick (1985), who was the principal White House official at the time of the Iranian revolution, concentrates on the historical events which led to the Shah's downfall. He offers views and reasons for the confrontation between the US and Iran. He also contends that the Iranian revolution, which he refers to as a "political earthquake", changed the landscape of politics not only Iran but also for the whole of the region.

Another study of events which led to political upheavals and finally the Iranian revolution in 1979 is Abrahamian's (1982) analysis of the turn of events. Abrahamian looks at the make-up of societal and tribal cultures within Iran to develop his argument about the effects of the political and sociological root causes of the constitutional revolution of 1906. The historical background to this study finds strong linkages between Islam and the uprisings of the two revolutions which were seventy years apart.

Without understanding the underlying currents of thought among the Iranian opinion formers and intellectuals who pursue their aspirations in politics with a political will that is dressed up in religious clothing, it would be hard to find the symbiosis for the changes Iran has been experiencing. Boroujerdi (1996) examines the Iranian Revolution in terms of its socio-economic and cultural effects, as well as ideological factors. The study looks at how Americans perceive present-day Iran, whilst also shedding light on how Iranians view the West.

Mottahedeh (1986) takes a look at the Iranian revolution from the perspective of Shia schooling at the religious seminaries. He examines how, through a mediaeval system of learning, the interweaving linkages are made between history, philosophy, biography and the study of religion, to arrive at the current political thought prevailing in Iran.

A growing popularity of religion and mysticism had already taken place among the secular intellectuals in the earlier years of the decade prior to the revolution of 1979. Their concept of religion, argues Nabavi (2003), was not a rigid Islamic state, since they had arrived at the idea under the influence of Western thinkers who had become disillusioned with the technocratic state; instead, they viewed religion as a concept that had the potential of being a catalyst for bringing about change.

Katouzian (2003) offers a critical overview of contemporary Iranian politics and society, based on different pieces written by the author over a period of more than twenty years. One of the main arguments is that the Shah's 'White Revolution' in 1963 was not a change from democracy to dictatorship, but rather a change from limited constitutionalism to arbitrary government. Katouzian insists, however, that the exploding oil revenues did not create arbitrary rule, although they facilitated it, because arbitrary rule has been the norm in Iranian politics. Moreover, the author believes that, by digging into the social and political history of Iran, his work contributes to clarifying the reasons for the unaccountability of the state and the ungovernability of the society (Katouzian, 2003).

Ehteshami (1995) focuses on what he calls the ‘Thermidor of the Iranian revolution’, that is the end of the revolutionary process and the beginning of the definitive establishment of the new regime. In fact, the Thermidor can be viewed as the most revolutionary change that could have affected the Islamic Republic. It is usually suggested that the closeness in time between the ceasefire in the Iran-Iraq war and Ayatollah Khomeini’s death accelerated this process of consolidation. The author deals with the question on what is actually replacing the revolutionary regime:

To denote the changes in the formal distribution of power in Iran since Ayatollah Khomeini’s death, the constitutional changes of 1989, the leadership style of Ayatollah Khomeini’s heirs, the content of the policies of the post-Khomeini leadership and the ways in which their policies differ from those of the Khomeini era, I have adopted the term of the Second Republic (Ehteshami, 1995:xiv).

Playing with a term that has been used by various writers, Fuller (1991) aims to explain and understand the idiosyncrasies of Iran, on the one hand, and the country’s relations with its neighbours and other nations, on the other. The geopolitical aspects of Iran as a result of historical events and cultural and geographical features are analysed, as well as Iran’s relations with Turkey, Afghanistan, Pakistan, other Arab states and Russia. Perhaps understandably, a considerable part of the study is dedicated to Iran’s relations with the Arab states in the Gulf region. The relations with Russia and the former Soviet Union also receive particular attention and Iran’s interest in the emergent Muslim countries and former Soviet regions is discussed as well.

Katouzian’s (1981) exploration of the political economy of modern Iran brings forth the idea that Iranian society was never particularly familiar with private forms of property, which explains the difficulties for a middle class with entrepreneurial skills to emerge and consolidate. While the author strongly dismisses the Pahlavi period as a combination of despotism and false modern consciousness, he also challenges the recurrent myth in Iranian discourses by which domestic political problems and struggles

are viewed as the result of the conspiracy of foreign powers. Hence, Katouzian (1981) vindicates the role of the Iranian people, its actions and ideas, in the shaping of their country's history and, by extension, its economic development. On this note, we proceed to discuss the actual research question behind this thesis.

Nili *et al.* (2004) focus on how human life is fraught with strenuous efforts to raise living standards and enhance welfare, suggesting that as an historical regularity, public policy embedded in social and political institutions has always played an important role in directing and transforming individualistic efforts into socially desirable outcomes. Thus, Nili *et al.* contend, in the absence of public policy, the world's per capita income during thousands of years prior to the nineteenth century remained fairly unchanged. Nili *et al.* draw parallels from the age of enlightenment, the industrial revolution, along with more recent technological and scientific advances to illustrate the necessity for institutions and institutional fundamentals within Iran's socio-political and economic fields. Discussing the issue of privatisation in Iran, Nili (2004) emphasises the need to review how and why Iran has failed in its attempts to privatise so far, why Iran has been so unsuccessful in its experimentation with structural reform, and the lack of political will amongst the elite opinion formers and policy-makers to adopt a more gradual process.

Finally, two further volumes deserve a mention in this section before I move on to my research question, namely those of Ramazani (1990) and Milani (1988). Ramazani has compiled a book with six leading scholars, describing and analysing key aspects of the revolution in Iran, whereas Milani has framed his research work based on the historical politics which culminated in the revolution of 1979, and the post-revolutionary politics of the land.

