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Abstract

Iran changed the system of its government from a non democratic situation toward democracy after Islamic Revolution in 1979. In the new period, people could elect their governor through general elections but they didn't have an acceptable freedom about what they produce and consume because of a governmental economic system. Reaching to a democratic economy, after Eight years, Iran liberalized its economy in 1989 through executing of three main economic policies which were Marketization (prices determination in the market), foreign exchange policy and privatization. In this article we will discuss the first policy, Marketization; we will find the reasons for its execution i.e. completing the democracy, optimizing of economic activities (production and consumption), high level cost of direct price control and defeat of efforts for direct price control in previous period. In the next stage, we will survey mechanism of executing of marketization in Iran. Results of marketization and its effects on the economy of Iran will be described in continuation of this article. Difficulties faced the policy and extent of its success will be the final part of the article.

Marketization and Democracy in the Islamic Republic of IRAN

Eight years after executing governmental economic policies, Iran liberalized its economy in 1989 through executing of three main economic policies which were Marketization, foreign exchange policy and privatization. We use the word Marketization to describe the transition of economy toward a situation in which there is no direct price control by the government and the prices are determined by the market forces. Iran has moved away from a regulated low level foreign exchange rate policy, towards bringing the official exchange rate close to the free or black market rate. So we can look at this change as a part of Marketization but due to its importance it is necessary to categorize and survey it as a separate topic.

In this article we will discuss the first policy, Marketization; we will find the reasons for its execution, its effects on the economy of Iran and the extent of success of this policy. Executing of Marketization policy faced many difficulties due to the fact that people, particularly journalists, theologians and other persons who lead or affect the public opinion, believed that there is a strong relationship between Marketization and inflation rate. So in case of facing high inflation rate they used to attack Marketization.

Before Islamic Revolution, IR, most of the prices were determined in the market in the economy of Iran. After IR particularly when Mr Mousavi who strongly protected economic conservative policy came to power, most prices were determined by the government. These governmental prices were notably lower than black market rates so, there was an extra demand for each commodity and therefore the government used some restrictions like coupon or quota on a large scale in both commodity market and some parts of factors markets. There were a few organizations which had been established for the execution of these controls. Their duty was affairs like issuing coupons, quota orders, distributing and collecting of them, price determination etc. Many employees were working in these organisations. In the city of Mashhad, for instance, which had about 1.4 million populations, there was an organization for distribution of iron and profile with about 120 employees. In addition to iron and profile, there were many items which had to be distributed and it is clear that a large number of employees were working in this sector.

In this article we will first discuss the reasons of Marketization. In the next stage the manner of execution of this policy and total effects of it will be explored.

1. The Reasons of Marketization

There were really two main (general and special) reasons that led to Marketization. The belief to economic freedom and negative economic indices and almost economic crisis were the general reasons while optimizing of economic activities, high level costs of direct price control and defeat of control price efforts form the especial reasons.¹ There is a book titled “After Four Years” which is an

¹-After Four Years, p.58.

official document and published by the government in which new policies and governmental activities in first four years of liberalisation period are briefly explained. We translate a paragraph of it which is related to our discussion.

"The dual price system and sometimes multiprice system was a factor which used to encourage the opportunism in the commodity market. Therefore the official prices were gradually led toward market equilibrium prices. It is necessary to say that in a dual price system, the consumers like to get commodities with cheaper prices, so, they hostilely compete to take cheap and scarce goods.

Keeping the non real and low level prices was impossible except the government spent a large volume of money on it. So, the prices gradually went towards market prices. The other activity of the government was leading the market to such prices in which there is a reasonable profit for producers and no injustice for consumers."

1.1- General Reasons

The first and most important reason for liberalization and marketization was the consisting on economic freedom by the Islamic leaders and **completing the democracy**. They used to tell that, except prohibited cases like alcoholic drinks, pork meat etc., Islam has not allowed the government to decide people what produce and what consume. These Islamic leaders were quiet during the conservative period due to the war conditions but after war they didn't allow to continuation of governmental economy.

It should be noted that after I.R Iran has had a democratic political system and people have elected the political men of the country while they had no freedom to decide what they produce and consume in many cases. It is notable that there are many non democratic governments that have liberal economy but it was an exceptional case in the world that a country has a democratic political system and a governmental economy at the same time. It is necessary to remind that freedom was one of the main purposes of Islamic government of Iran.

We discuss about other general reasons of marketization know. Economy of Iran in the years under governmental system gradually went toward a crisis. Low level and finally negative growth rate of GDP, per capita income, investment, budget deficit and many other bad indices according to tables no 1 to 3 and figures no 1 to 3 confirm this matter. In addition to war with Iraq which undoubtedly had a great impact on the economy of Iran, the governmental economic system has been calculated as a main reason for this bad economic situation. This general bad economic situation created a national feeling against governmental economy and many people believed the necessity of liberalization and Marketization. We show the above mentioned bad economic situation only through some tables and figures during the years 1980 to 1988 for briefness.

Table No 1

Private, Public and Total Consumption Before Liberalization Period (1982 Constant Prices)

Rls Bn

	79-84	85-88	89-94
	Ave.	Ave.	Ave.
Private			
Annual GR	5		7.0
Public			
Annual GR	-3.6	-9.7	6.3
Total			
Annual GR	3.28	-6.1	6.8

Sources: ERBS 1993 and ISY 1994

Table No 2
Growth Rates Of GDP by the Sectors During The
Conservative Period at 1982 Constant Prices Percent

	Average Growth Rate	
	1979-84	1985-88
Agriculture	4.9	1.4
Oil	-8.5	2.2
Manufacturing & Mining	7.8	1.5
Water Electricity & Gas	7.1	4.8
Construction	3.3	-17.5
Services	3.7	-18.1
GDP	1.9	-7.3

Source: ERBS, 1993, P.37.

Figure No 1
GDP and Non Oil GDP Growth Rate At 1982 Constant Price

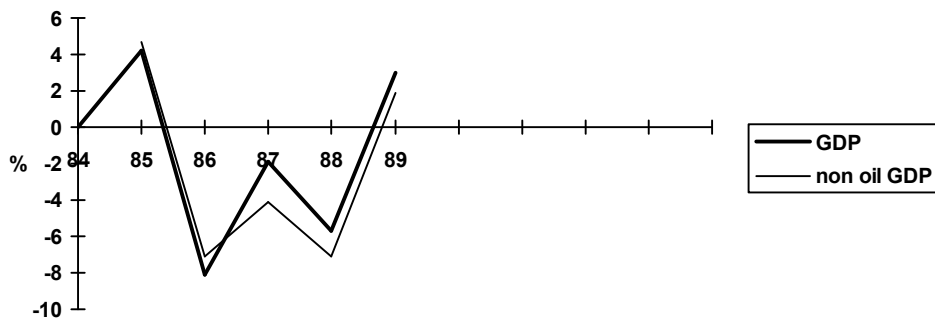


Figure No 2
Growth Rates Of GDP in Different Sectors of Economy of Iran During The Conservative Period

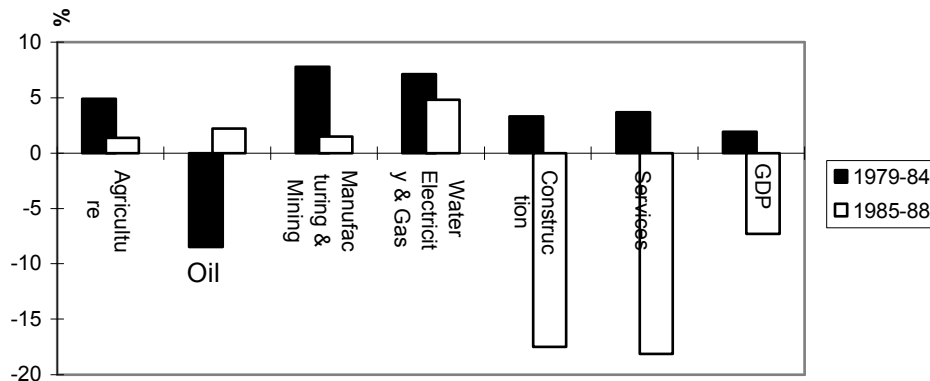


Table No 4

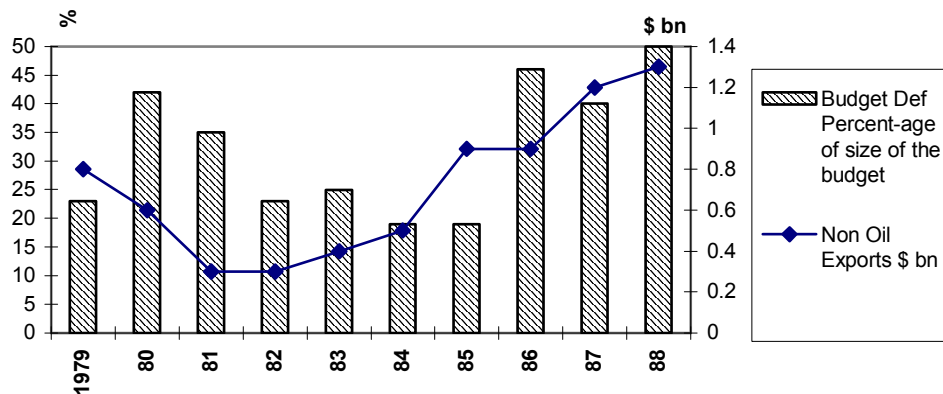
The Amount Of Budget Deficit, Imports And Non Oil Exports During The Years 1979 To 1988

	1979	80	81	82	83	84	85	86	87	88
Budget Def Percent-Age Of Size Of The Budget	23	42	35	23	25	19	19	46	40	50
Imports \$Bn	9.7	10.8	13.5	11.8	18.1	14.5	11.4	9.4	9.4	8.2
Non Oil Exports \$ Bn	0.8	0.6	0.3	0.3	0.4	0.5	0.9	0.9	1.2	1.3

Sources: ERBS, Years 1983, 86 & 88

Figure No 3

The Amount Of Budget Deficit, Imports And Non Oil Exports During The Years 1979 To 1988



1.2- Especial Reasons For Marketization

As mentioned earlier, the especial reasons of Marketization are categorised in three topics as follows:

- Optimizing Of Economic Activities
- High Level Costs of Prices Control
- The Defeat of Efforts for Prices Control

1.2.1-Optimizing Of Economic Activities

In the direct price control period, 1981 to 1989, many economic activities were not optimum or even near to optimum. These could be explored in two divisions, production and consumption. We will continue our discussion in these two topics.

A-Low Level And Non Optimum Production

Before any discussion about the main subject of this topic we should explain the commodity evaluation and price control mechanism in the conservative era. In this period, the government used to actually use the Cost - Value Theory of David Ricardo. We know that according to this theory, the price of every good is equal to its direct costs plus a reasonable profit for producer or distributor and there is, therefore, no place for market demand to affect the price in this theory. In addition, there was a fixed foreign exchange regime in which the government used to provide necessary exchange for imported requirements at a low level rate in that period. This process led to a low level cost of

production directly in case of domestic goods and a lower price in case of imported commodities.

As a result of these two reasons (cost - value price determination and cheap exchange) the governmental prices were much lower than market prices. On the other hand, it is clear that there was a large extra demand for these cheap goods, so the government had to decide to whom these commodities should be allocated; otherwise they were sold in the black market at a higher rate. Therefore, a great governmental organization was established for distribution of intermediate and consumer goods through the quota policies and execution of it in many commodities including imported and domestic goods.

It is clear that this price system drives production sector away from optimum situation. This process was happened through 3 ways: no excitement for optimum production, investment crisis and downing the production level.

A.1- Non Optimum Production: when the government restricts the profit rate of producers to a fix rate suppose 10%, there is, naturally, no difference between many commodities to be produced because every one has the same profit rate without any relation with the demand level. This problem in production has occurred in economy of Iran in the period under consideration. Many producers used to decide about their industry through another factors like the possibility of taking governmental exchange rate, selling their goods in the black market, etc. There was no relation between their decision and market demand.

A.2- Investment Crisis: There has been an old problem in the economy of Iran especially in the time period in which a direct price control was executed. This problem was that the profit rate in business activities, especially in gold and forex market, was noticeably higher than the productive activities. This difference had been strengthened under the direct price control system because the profit of production was more restricted when the producers had to sell their commodities at a notably lower price than the black market rate.

In such a situation, the investors and capital owners would prefer not to invest in the productive project and keep their money in the more profitable markets i.e. Gold, forex etc. Table no 4 shows the new industrial investments during the years 1982 to 1988 in which the direct price control had been in force. We can see in this table that despite a high inflation rate, there has not been a notable increase in the nominal value of investments while there is a noticeable decrease in the number of new permits for industrial projects between 1984 and 1988. It is necessary to say that many of these permits have not been productively used because their applications were only a way for taking forex at official rate. These forex receivers used to sell these exchanges in the black market or spend them for importing of more profitable imported goods through a contraband way and the permitted projects did not continue so the real investment was much less than figures shown in the table.

Table No 4

Industrial Investment Based On Establishment Permits And Number Of These Permits

	1982	1983	1984	1985	1986	1987	1988
	1361						1367
New Investments- Mn Rls	41971	58740	55640	48505	51276	73145	71649
Number Of New Projects	1678	2065	1943	1351	1082	871	716

Source: Ergs 1986 And 1987

A.3-Downing The Production Level: The above mentioned story is valid for productive units also. Every producer had a foreign exchange quota for importing his primary or intermediate goods which were required for his production. Because of the low level profit in the productive activities, these producers used to transfer their exchanges to the black market as much as possible. They did not also deliver a part of their products for governmental distribution at official rates despite their obligations. They used to sell these products in the black market for more profit.

It is clear that under such price conditions the production especially in private sector would comes appreciably down. In these years, many of productive units worked below their normal capacity owing

to low profit which was caused by the governmental price and distribution². It is said in some reports that many of these units used to produce only about 40% of their normal capacity. Therefore, a notable amount of country's foreign exchange and domestic resources went to the black market and changed in to swindled imported goods whereas the government was committed to restrict these activities (just the opposite of the optimum activities).

If we even suppose that the producers never used to illegally act against rules, the problem of non optimum production will still remain unchanged. We already mentioned that every producer had a foreign exchange quota for importing necessary raw materials and intermediate goods. The forex amount received by many producers was much lower than his official quota due to government forex problem and high level demand for forex. So producers couldn't apply equal to their nominal capacity. It should be noted that the forex allocated to producers was depended on many things like exports of oil, government's requirements specially war requirements and the demand of producer was only one factor and normally a producer did not completely get his requirements.

This process did not allow to market demand to have a role in deciding the amount of quotas and consequently the amount of production. Under these conditions, many producers whose products were not important, like luxury goods producers, received exchange quota like those who produced more necessary goods.

It was a drastic belief among the new economic policy makers that Marketization is the best way for leading economic activities towards an optimum situation. They knew and forecast some economic difficulties like rise in inflation rate but selected this policy owing to its greater usefulness.

B-Non Economic Consumption

Under the direct price control system, many consumer goods used to be consumed in a non economic way. A large number of people used to buy some commodities due to their cheapness though they did not normally purchase and consume those goods. There are a huge number of examples for non optimum and even non economic consumption. As an instance we refer to some house commodity like freezers. Due to cheap price, in these years a large number of freezers were allocated to some families who did not have enough things to keep in them, and actually went to places in which they were not useful. This caused distortions in consumption decision and a lot of wastage.

1.2.2-High Level Cost Of Direct Price Control

After optimizing of economic activities, the second important reason for Marketization and abandonment of direct price control system was the high level costs of this system for the government. There were two types of costs which had to be financed by the government, cheap foreign exchange and direct costs.

A-Cheap Foreign Exchange

The governmental prices were dependent on the existence of cheap forex which had been given to the producers by the government. It is interesting to note that the official rate of US \$ was almost equal to Rls 70 whereas this rate was between Rls 200 to 1400 in the black market. Therefore, in absence of a cheap foreign exchange, the cost of production had to naturally rise and consequently those low level governmental prices went up to the level of black market prices.

Just owing to the above matter, Marketization was not avoidable after taking liberalization policies. We previously said that the new policy of Central Bank under the liberalization was unit and flexible exchange rate. It is necessary to say here that due to some reasons the Central Bank of Iran devalued Iranian Rial from Rls 70 per US \$ to Rls 2300 in a few steps.³

Besides the Central Bank of Iran had no longer the ability to give cheap exchanges because the forex revenues of the country had come down after 1984 due to the war namely tankers war and falling world price of oil which limited the ability of government for the above purpose. It is useful to say that the annual forex receipt of the Central Bank was more than 20 bn US \$ in the years 1981, 1982 and 1983 whereas it was about \$ 10 bn in the years 1987 and 1988⁴. In these condition although the last governors did not officially change their price control policy, they unofficially allowed to producers to sell their goods at a higher rate or in the black market.

2 - Some persons believe that the scarcity of forex caused this problem. But this belief is unacceptable because in some years like 1983 and 1984 there was a huge amount of forex revenue.

3 -ERBS 1993

4 -ERBS 1986 and 1988

B-Direct Costs Of Price Control System

Iran is a relatively big country with about 1,648,000 square km area, about 60 mn populations and a large number of big and small cities. It is clear that in such a country, direct commodity distribution or direct price control needs a large amount of cost.

It is necessary to say that in the years of economic conservatism there were three groups of goods in Iran. The first group included most important consumer or intermediate commodities which were under the direct state price determination and were distributed through coupons, quota sheets etc. The number of these commodities was about 80 in the year 1984 including food, oil, rice, refrigerator, etc.⁵. The second group of commodities were those which had only been under state price determination and were distributed by the private sector. The number of goods in this group was more than the first group. The other commodities like luxury goods and those whose price control was impossible like houses and buildings had been located in the third group. The prices of these commodities used to be determined by the market forces which have been strengthened in that period because a notable amount of market liquidity had shifted to this market due to higher profit rate, security and a good possibility for capital outflow in case of necessity.

There were two governmental organizations which had the responsibility and duty of the above mentioned distribution of goods, price determination and control. The Ministry of Commerce was the first one. The number of this ministry's personnel had risen from 10733 to 21461 persons during only two years (1982 - 1984)⁶ owing to new duties. The second one was a newly established organization (just for the above mentioned purposes) named Setad Basij Eghtesady (economic mobilization staff). This new establishment had been organized in the Prime Ministry Organization so there was no direct information about its personnel or budget but the personnel of the Prime Ministry Organization rose from 26713 to 39299 during the above mentioned two years⁷. In addition to these two organizations, many other governmental organizations and establishments like banking system, Ministry of Finance and even non economic ministries were indirectly working in this direction and a part of their personnel was busy in these activities.

It was very difficult for government to tolerate such large costs whereas it had a great budget deficit and other important budget problems. Therefore, we can say that the ignoring of these large costs was the second reason for Marketization. It is interesting to know that the number of Commerce Ministry's personnel has come down to 14938 (about 35%) in the liberalization time (1991) including Setad Basij Eghtesadi (economic mobilization staff)⁸.

1.2.3-The Defeat Of Efforts For Direct Price Control

In the economic conservatism period, because the determined prices were very low, there was a great tendency to overcharge commodities among the sellers, shopkeepers, distributors and even the producers and companies. This matter used sometimes to create some great economic or even social crises. In such situations, the government used to do some extraordinary activities against overcharging. There are some bad experiences in the area of efforts to control overcharging because none of these efforts was successful, so the attempt to stop overcharging was discontinued after a short time like one or two months. These failures gradually strengthened the belief that it was impossible to have permanently low governmental prices and market forces finally would win in this duel.

This drastic belief had created a strong tendency to Marketization among the decision makers who came to power after the year 1989.

2-Mechanism And Results Of Marketization

2.1-Mechanism Of Marketization

In this part we first briefly discuss the mechanism of Marketization. We already mentioned that there were three categories of commodities before the execution of new policies of which the prices of only one were determined by the market forces. The prices of other two groups of goods were determined at a low level owing to two factors which were cheap foreign exchange and state price determination.

It is clear that the government needed to change these two factors for Marketization. Without an adjustment in the forex rate, it was impossible to marketize the prices due to relative profit rates. It means that if the government marketize the prices with a cheap exchange rate, the costs of production

5 - A Statistical Reflection of the IR. Iran .No .12.

6 -ISY 1982 and 1984

7 -IBID 1982 and 1984

8 -A Statistical Reflection of IR. .Iran, No 12

in those manufactures which use more imported primary or intermediate goods will grow less rapidly than those which use less of these imported goods like agricultural sector or some industries like glass manufactures. It goes without saying that in such a situation the profit rate of manufacturers using more imported goods will notably be more than the others. Undoubtedly, this situation is very dangerous because it would cause large scale structural shifts of labour and capital and the economy of Iran does not have the resilience to withstand the impact of a large number of changes in its industrial structure.

The government did both of these necessary activities to marketize the prices. It adjusted the forex rate in a few steps. It raised the US \$ price from Rls 70 to Rls 800, then Rls 1750 etc. So that the official rate and free market rate were very close. On the other hand, the state price determination and control became less and less and the economic movement's staff was shifted and reorganized in the Commerce Ministry, together with a reduction of the staff and disorganization of most of its sub establishments. In addition, the government gradually cut the quotas and allowed the producers, distributors or consumers to negotiate directly about every thing including prices. This process lasted about two years and after that there were no governmental prices and distribution except in some basic goods like bread, food oil, sugar etc.

2.2-Results Of Marketization

From the first years of the first 5 year economic plan (liberalization period's beginning) the government, specially the president, had announced that Marketization would be continued till the time in which there would be equilibrium in the market. This process continued on a large scale up to 1994 but after this year the government was forced to slow this process due to some problem specially a high inflation rate.

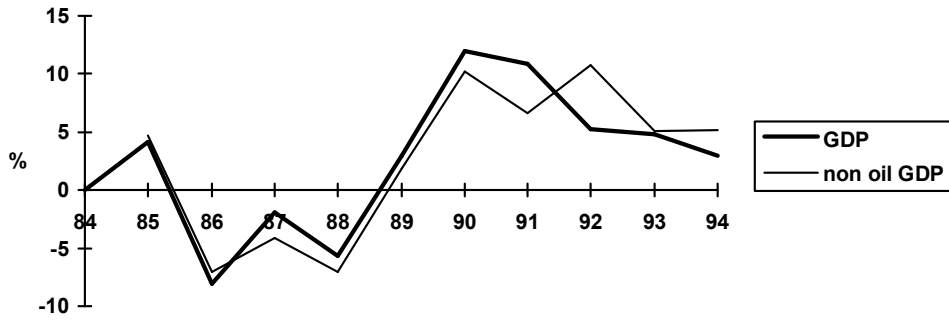
All the economic transformation occurred in the period under consideration were related to all three liberalization policies i.e. Marketization, privatization and forex policy and It is very difficult to survey the results and impacts of only Marketization on the economy of Iran. We briefly show these economic transformations as a result of these policies through some tables and figures here. Private, public and total Consumption ,growth rates of GDP by the Sectors ,budget deficit, imports and non oil exports during the Years 1979 to 1988 at 1982 Constant Prices and some sectoral information are the information titles shown in these tables. It is clearly seen that most of economic indices which had been very bad and negative in the conservative period have improved during the liberalism period. It should be noted that an important share of these improvements belongs to the ending of war between Iran and Iraq but it is very difficult to exactly determine this share.

Table No 5

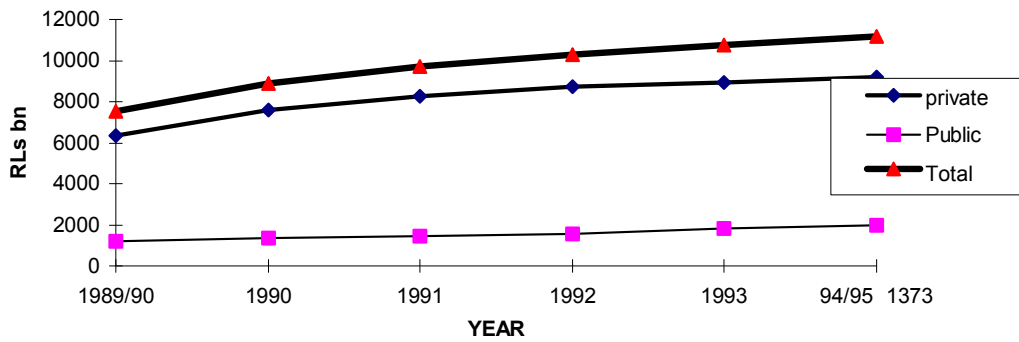
Macro Economic Indices At 1982 Constant Prices

	1989/90 1368	1994/95 1373	Aver GR
GDP At Factor Cost -Rls 10 Bn	951.46	1346.52	
Annual Growth Rate -%	3.0	3.0	6.61
Non Oil GDP At Factor Cost	7625.1	10969.1	
Annual Growth Rate -%	1.9	5.2	6.6
Per Capita Income At Constant Prices-1000 RLS	1981	2432	-
GNS -RLS Bn	1416	2430	-
Private GFCF - Rls Bn	748	1243	-
Public GFCF - Rls Bn	469	890	-
Total GFCF - Rls Bn	1217	2133	-
Share Of GFCF Out Of Total GDP -%	12.4	16.5	
Share Of GNS Out Of Total GDP -%	14.5	18.2	

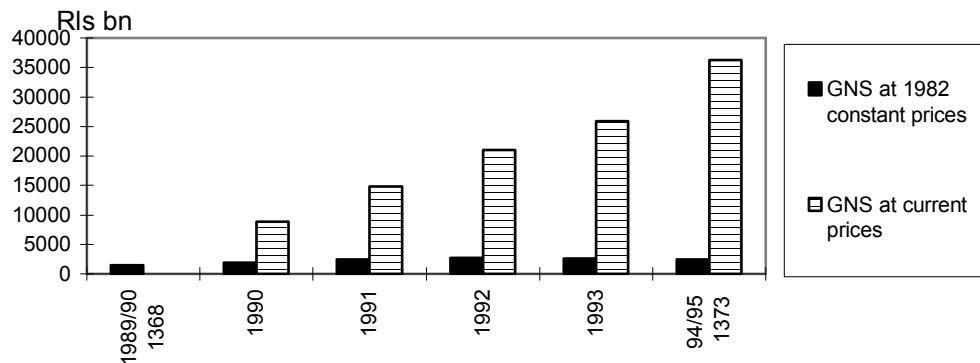
Gdp And Non Oil Gdp Growth Rate
At 1982 Constant Price



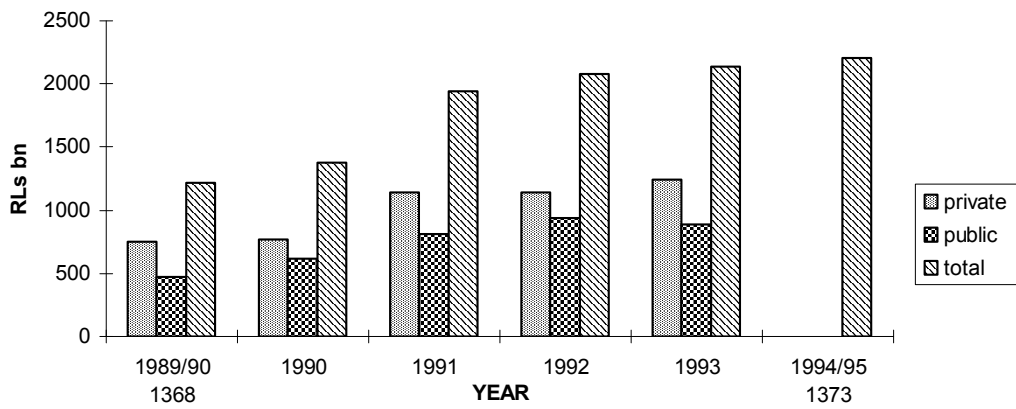
Private, Public And Total Consumption
At 1982 Constant Prices



Gross National Saving(Gns)



**Gross Fixed Capital Formation(Gfcf)
At 1982 Constant Prices**



**Table No 6
Government Revenues, Payments And Budget Deficit**

	1989/90 1368	1994/95 1373
1-Revenues	3174.6	29244.5
Oil And Gas	1488.1	21479.7
Taxes	1187.8	5490.8
Others	498.7	2274
2-Payments	4316.7	29595.5
3-Deficit Or Surplus	-1142.1	-351.0
Budget Deficit-%	26	0.1

Government Revenues, Payments And Budget Deficit

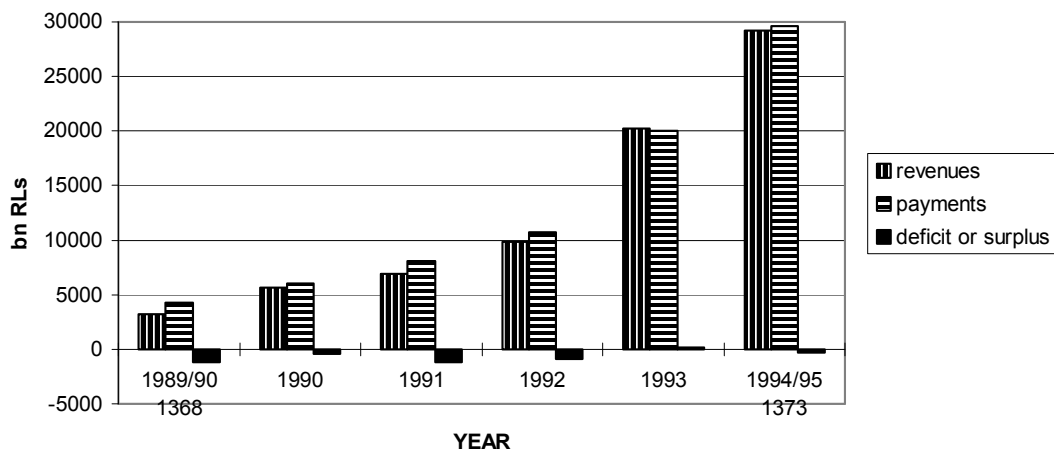


Table No 7
Production Of Some Agricultural And Livestock Items

	1000 Tons	
	1988	1994
	1367	1373
Wheat	7265	10870
Barley	3394	3045
Rice (Paddy)	1419	2259
Sugar Beet	3454	5295
Potato	1443	3185
Red Meat	560	658
White Meat	330	613
Egg	280	516
Milk	3827	4450

Table No 8
Production In Construction And Manufacturing And Mining Sector

	1989	1994
	1368	1373
New Structures In Urban Areas By The Private Sector-1000 Mtr²	17493	28608
Production Of Manufacturing And Mining Sector- Rls Bn - 1982=100	1476.5	2141.1

Table No 9
Investment In Industrial Sector

	Rls Bn	
	1989	1994
	1368	1373
New Constructional Investment By The Governmental Sector	49.944	573.100
New Constructional Investment By The Private Sector	1067.805	5566.988
Total Constructional Investment	1117.749	6140.088
Government Industrial Investment	164.0	293.5
Private Industrial Investments	93.1	3353
Total Industrial Investment	257.2	3646

Table No 10
PRODUCTION OF OIL, GAS AND OIL PRODUCTS

	1989/90	1994/95
	1368	1373
Crude Oil Production- 1000 Bpd	2716	3603
Production Of Oil Products - 1000 Bpd	824	1214
Production Of Natural Gas-10 Mn Cu Mtr.	3220	5490

Table No 11
Investment In Oil And Gas Sub Sectors

	1989/90	1994/95
	1368	1373
Oil	170.8	2614
Gas	87.3	450

Table No 12
Production In Infrastructural Sector

	1989/90 1368	1994/95 1373
Electricity - Bn Kwh	52.712	82.019
Agricultural Water - 10 Mn Cu Mtr.	85.1.5	107.7
Water Provision For Cities And Industries – 10 Mn Cu Mtr.	13.9	43.0
Total Water -10 Mn Cu Mtr.	99.5	150.7
New Lands Under Irrigation And Drainage Networks - 1000 Hectares	60.9	122
Construction Of Main Roads -10 Km	60.7	50.0
Construction Of Regional Roads -10 Km	98.1	80.0
Construction Of Rural Roads -10 Km	95.0	70.0
Total Passengers Transported -10 Mn Passengers	62.5	83.5
Total Cargo Transported -10 Mn Tons	66.0	51.8
Total Mail Received - 10 Mn Units	28.1188	16.3683
Total Mail Dispatched - 10 Mn Units	26.9761	14.5719
New Installed Telephones , 1000 Telephones	179.7	745.4
New Rural Telephone Centres, Unit	506	800

Table No 13
Investment In Infrastructural Sector
At 1982 Constant Prices

	1989/90 1368	1993/94 1372
Electricity	62.1	112
Road And Transportation	62.8	108
Telecommunications	45.3	130.9

Table No 14
Non Oil Exports Of I.R. Iran During The Period

Year	NOE Mn US \$
1989(1368)	1044
1994(1373)	4831

Since 1995 owing to a high inflation rate, Marketization and forex policy were relatively changed. According to ERBS the inflation rate was 35.2% in 1994 and there were some worrying about social or economic crisis in these conditions. After a few months, the government started direct price determination for many goods and fixed the official forex rate at the same time but, contrary to the economic conservative period, the new determined prices were very close to the market prices and the price determiners had paid attention to the market demand so, we can say that Marketization has not notably changed in this phase also.

In spite of the above mentioned difference and despite the fact that the government had already announced that in an equilibrium situation price control policy would be reintroduced, some observers strongly believe that new economic policy changes are only related to the inflation rate and the government will marketize the economy in a normal conditions again.