Public Administrative Reform for Economic Transformation in Iran: The Legal Framework

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Governance, the State and the Politics of Development

NOBODY DENIES that fair governance is both a valuable aim and an instrument of development. What’s fair governance? The term ‘fair governance’ has two meanings in the modern usage. The first meaning, which is more limited, considers administrative and managerial aspects merely. The second one, though taking into account a decent governance, emphasizes a political regime which establishes the system and guarantees her continuance. 

In the first meaning, governance is an independent capacity, apart from politics and the structure and policies of the state, with the following characteristics:

- Accountability, that is, making state authorities responsible for their actions.
- Legal framework of development, which is a consolidated set of laws and regulations, according to which, the non-governmental sector is able to understand clearly the circumstances, foresee the future, and expect stability. Laws and regulations must be impartial, meaning, they should be enforced equally on all, and an independent judicial system must secure the exact and correct enforcement of them.
- Information; it means that information about economic conditions, budget, markets, and state policies are reliable and accessible to all. For the non-governmental sector these information are of critical importance.
- And finally, transparency, for a transparent state, this characteristic is a means to promote accountability and responsibility of the authorities, as well as a device to limit corruption and encourage the exchange of views between government and non-governmental organizations in planning and policy-making.

The first meaning is incomplete, since it forgets that fair governance is subject to the characteristics, capacity, and ability of the state, and hence subject to politics and the political regime. Experience of the countries that have recently entered the circle of developed countries indicates that both political will and efficiency of governance have contributed to the progress of the development process. Therefore, it is incorrect to conceive fair governance in the absence of a development-oriented state.

According to the second meaning, administering or managing development is not conceived as a pure technical or practical issue, and hence, the effective capacity and
ability of the governmental sector to advance development is not merely subject to fair governance. Since development is essentially a political issue, it would be misleading to conceive of fair governance apart from the political regime and the state to realize it. But the immediate question is, which political regime and state is capable of building fair and decent governance to realize national development aims?

The Idea of the Development-Oriented State

Until the 1980s, the clear answer of the western countries to the above question, which was the main precondition of their economic aid, indicated that a political regime committed to the western type of democracy and based on market economy is the only political regime capable of establishing fair governance. But successes of several countries to attain economic development and growth, without a political regime conforming to the western democratic pattern of governance, proved the idea to be wrong. The idea of the development-oriented states that arose from the successful experiences of several countries, particularly in east Asia, was gradually presented in developmental studies. Some common aspects of the development-oriented states are as follows:

1. Development-oriented states, whether democratic or not, have been officially or practically one-party regimes.

2. In these governments, the prevailing faction is a group of determined, purposeful, and development-committed elites.

3. The development-committed elites have preferred national interests to factional interests.

4. The elite’s resolution, as well as a relatively independent state from factional interests, have established a powerful and efficient economic bureaucracy with the necessary power and authority to conduct economic and social development.

5. And finally, these states, whether democratic or not, have not been desirable either by democratic or by socialist criteria.

A characteristic of the development-oriented state is that mainly political factors, such as ideology or nationalism have formulated their development strategy. The outstanding success of the development-oriented countries, whether democratic or not, is the outcome of the initiatives by a state that enjoys power, honesty, independence, and efficiency to realize national development aims. The development-oriented state supports a powerful and efficient governance which conducts policy and planning of development.

The Islamic Republic of Iran possesses political characteristics that distinguish her from the common pattern of liberal and socialist governments, since her statesmen have arisen among revolutionary masses and feel themselves committed to them. In addition,
the grand teachings of Islam make the political system and the state responsible for the development and growth of the country and the elevation of mankind; therefore, despite all difficulties that domestic and foreign factors have created, she has succeeded to carry out fundamental development plans. Thus, the accomplishments of the Islamic Republic of Iran indicates clearly the commitment of the political regime and the state to the development of the country.

In order to clarify the administrative reforms that are beneficial to the economic conditions of Iran, the economic situation, facilities as well as limitations will be discussed in the next section.

**Economic Reform and the Reconstruction of the Iranian Economy**

Since the 1979 revolution, profound changes have taken place in the Iranian economy as a result of a combination of external and internal factors. The trade sanctions and freezing of Iranian assets that followed, the costly and protracted eight-year war with Iraq, and fluctuations of the oil market all have made their mark on the economy. The Islamic Republic of Iran’s response to these crises was to follow a policy of severe import compression and reliance on bureaucratic arrangements as principal allocative and distributive mechanisms in the economy.

There is now a general consensus that the economy is badly in need of reconstruction. The First Five-Year Plan (1989-1993) represented the government’s manifesto for the reconstruction of the Iranian economy, and laid down a blueprint for Iran’s future development. The First Five-Year Plan provided an important framework within which government could embark on a program of structural reform and economic liberalization. According to the latest data released by the Central Bank of the Islamic Republic, over the five years covered by the plan, the real GDP has grown by an average annual rate of seven per cent, which is only slightly below the plan’s overall growth target.

The problem of reconstructing the Iranian economy is reconstruction of economic infrastructure. It requires a whole new way of thinking about the role of markets and price and non-price signals in the allocation of the economy’s scarce resources, in the adoption and assimilation of new technologies, in manpower training, and in a more comprehensive and equitable system of taxation. What is needed is a cohesive economic strategy to render economic decision-making gradually more responsive to the international market forces and domestic economic and political realities.

For economic reconstruction to succeed, it needs to be approached in a general setting that addresses not only the issues related to transition from a controlled war economy, but also the long-term problems related to the respective roles of markets and planning in the process of development. The accrual of substantial revenues from the oil sector to the government in a country like Iran inevitably confers an important role on the state in the process of development. These same revenues can also lead to over-centralizing tendencies
Planning and Markets in Pre-Revolutionary Iran

The effective operation of markets requires the establishment of stable political and legal systems within which property rights can clearly be defined and secured. Proper functioning of markets also requires a stable and largely predictable set of social and economic rules. Arbitrary and unexpected interventions by the government, which affect the value of the assets of individual agents in the economy, could reduce the security of property rights, and, hence, the effectiveness of markets.

In Iran, however, complete reliance on market mechanisms is neither feasible nor desirable. The particular form that government intervention may take depends on the specific problem at hand and cannot be decided on the basis of some general universal prescriptions and rules.

In an oil exporting economy such as Iran’s, in which the government directly receives a large proportion of national income in the form of oil revenues, planning assumes a more important role, as compared to non-oil exporting economies. The government needs to dispose of its oil revenues, and this needs to be done within a planning framework. The government’s expenditure plans, under these conditions, play a crucial role in directing the economy, as a whole, and in guiding and promoting private investment.

Due to the fact that oil is an exhaustible resource, oil revenues cannot be relied upon indefinitely. As a consequence, it is necessary to invest oil revenues, both in medium-term and long-term economic plans, to guarantee sustainable development after oil depletion. Therefore the sustainability of economic development cannot be ascertained merely on the basis of the construction of adequate, aggregate, man-made capital stock. What is even more crucial is to ensure an appropriate pattern of structural change in the economy. The significance of structural change highlights the importance of industrial strategy as an integral part of planning in the Iranian economy.

In an oil economy, oil prices are extremely volatile; the primary role of economic planning should be to improve the overall stability of the economy. Evidence regarding pre-revolutionary Iran, however, suggests that, despite the existence of medium-term planning, short-term fluctuations in oil export revenues were very quickly translated into government investment.

Structural change in an oil economy like Iran’s is crucial for long-term sustainability of economic development. A crucial aspect of structural change is the extent to which the industrial sector can take over the foreign exchange provision role of the oil sector in the long run. The import-substitution industrialization policies pursued by the Iranian government during the 1963-79 period had the paradoxical effect of increasing the economy’s dependence on the oil sector. At the same time the highly protected manufacturing
industries, which grew rapidly behind tariff walls, did not have the incentive to export. In fact the availability of ample foreign exchange revenues from the oil sector led to a reduction in the urgency of earning foreign exchange through manufactured and other non-oil exports. Oil revenues, by adding to government revenues, tended to alleviate the need for government revenues through taxation.

Planning and Markets in Post-Revolutionary Iran

The Islamic revolution, the imposed war, and Iran’s political and economic isolation from the west have brought about profound changes in the Iranian economy. Of course, the changes, in a major way have been conditioned by the pre-existing structure of the Iranian economy as well as by the policy responses of the post-revolutionary government. For example, the problems associated with the distorted and inflexible industrial structure that had developed during the pre-revolutionary period started to manifest themselves in the 1980’s, as three decades of rapid growth in oil-export revenues finally ended. Similarly, the undesirable features of the inflexible machinery of the government that had developed before 1979 began to be felt more clearly after oil revenues started to decline and the expenditure needs of the government grew rapidly as a consequence of the war and the economic excesses generally associated with the revolution.

One of the important institutional changes that took place as a result of the revolution was the nationalization of a considerable part of the industry as well as the entire banking system. Direct government controls over the economy, however, were continuously increasing, particularly spurred on by the exigencies of running a war economy.

Foreign exchange shortages, which became especially acute from the mid-1980s, led to a policy of strong import compression and strict foreign exchange controls and rationing. Growing shortages resulting from import restrictions and substantial budget deficits (resulting from oil revenues shortfall) heightened inflationary pressures in the economy.

To mitigate the impact of inflation on the standard of living, the government introduced throughout the war period an intricate system of rationing and direct subsidies for a large number of commodities. Government controls in other economic spheres also increased significantly during this period.

The Iranian economy in the 1980s, can be characterized as a managed war economy. Government interventions during this period were largely dictated by immediate force of circumstances. The economic reform program initiated by the government in the post-Iran-Iraq war period was intended to deal with some of these consequences.

The problems associated with the exchange rate and other price and quantity controls and the resulting inefficiency that developed in the economy and were intensified during the war years, were all too clear and led the government to introduce a comprehensive liberalization and restructuring program after the war. Reform of the trade and exchange system has been an important element of this ‘liberalization’ program. Monetary and
fiscal disciplinary policies are at the root of the problems that have created growth of inflationary pressures, foreign exchange shortages, and the gap between official and free-market exchange rates. Therefore, it is imperative to adopt a combination of correct monetary and fiscal policies to avoid problems of the past 15 years.

Finally, it is worth emphasizing that the success of any development strategy within an economic framework requires an adequate and stable legal and political environment before rational economic decision-making can materialize, both within the public and the private sectors. In the absence of a comprehensive reform program that encompasses these broader institutional requirements, economic measures, such as the unification of the exchange rate and the removal of price distortions on their own, will remain ineffective and can even lead to further economic hardships without any long-term benefit.

Public Administration and Public Administration Reforms in Iran

Public Administration

In the 1960s, enormous oil revenues as well as domestic and foreign socioeconomic forces led Iran into a new era which is characterized by vast development in the extent and nature of government functions.

The oil revenues expanded the authority of government on the one hand, and increased its capabilities to accomplish developmental plans on the other. Both of these factors contributed to the inevitable profound reorganization of public administration. The approval of the Civil Service Law in 1966, a comprehensive employment and administrative law at that time and afterwards, was part of the response to the circumstances in this period. The Civil Service Law included general regulations concerning employment affairs and established a new system in organizing public administration. The State Organization for Administrative and Employment Affairs, mainly responsible for the state policy-making in manpower, organization, and employment affairs since 1966, was established by the same law. Thus, in 1966 the previous administration was completely reformed, and the succeeding one, though improved profoundly since then, still continues as the prevailing system.

The structure established in 1966, though inefficient from the beginning, later on was affected by more difficulties. A major problem was disproportionate administration, financially supported by oil revenues and organized to meet individual interests, rather than actual circumstances of the country.

The victory of the glorious Islamic Revolution in 1978 produced revolutionary changes in all sectors including public administration. Regardless of the nature of these changes, they expanded further the previous disproportionate public administration. A large number of Court-affiliated institutions, manufacturing companies left by the owners, private bankrupt banks, public utility enterprises, and a large number of companies and institutes with nobody to manage, all needed urgent state decisions. Considering the rough conditions of the early revolutionary period, the first measure imaginable was either to connect them to
the state, or to have the state sponsor them. That naturally resulted in public administration expansion and abnormal enhancement of state functions and responsibilities. Ever since the victory of the Islamic Revolution, the great volume of amendments approved by the Revolution Council, the Islamic Consultative Assembly (Majlis), and the Council of Ministers to improve the former administration, implies the depth of the problems inherited.

The Imposed War by Iraq

The commencement of the war in 1979, which was protracted for nine years, had severe impacts on administrative and economic affairs. The continuance of war for a long time, forced the state to be involved directly or indirectly in various economic activities, foreign trade, imports and exports, rationing of strategic commodities, and so on. Furthermore, diminished oil revenues, due to the reduced oil prices, economic sanctions imposed by the U.S., and even military threats and operations against the Islamic Republic of Iran, forcibly led the state to intervene in various spheres of society. In the same years, new ministries, institutes, and public corporations were established to deal with the new responsibilities of the state.

The end of the war abolished previous emergency conditions which led to the expansion of public administration; thus, new ideas and initiatives emerged to limit administration by integrating or dissolving ministries, state agencies, and public corporations and/or to decrease their functions and responsibilities. The same thought and measures still continue to prevail in the government.

One year after the end of the imposed war, the Constitution of the Islamic Republic of Iran was amended, membership was eliminated and the executive powers concentrated in the presidency. In addition, the responsibilities of administration and civil service affairs, as well as planning and budgeting were delegated to the president.

The First Plan

Because it has experienced a revolution and has been involved in a war for nine years, the Islamic Republic of Iran has great responsibilities. Moreover, since the major part of the national income comes from oil revenues, economic planning, at least in the macro level, is imperative. Economic planning is also stipulated in the Constitution. Therefore, immediately after the end of the imposed war, the First Five-Year economic, social, and cultural development plan (1989-1993) was ratified. The above mentioned law is the first comprehensive attempt to improve economic, social, and cultural affairs of the country. Public administration has been duly considered in the First Plan.

Some of the strategies and policies of the First plan regarding administrative reform are as follows:
• Rationally limiting of the number of decision-making and policy-planning authorities;

• Reorganizing public administration with regard to functional homogeneity, as well as the absence of duplication and overlapping of functions and responsibilities;

• Improving management and manpower of public administration;

• Improving laws and regulations applied by the state agencies; and

• Utilizing progressive administrative technologies and improving working methods.

It is worth mentioning that the First Plan established a specific authority—the Administrative High Council—to make surveys and decisions on administrative reforms. Its work has brought about vast changes in Iranian public administration.

THE SECOND PLAN

The second five-year economic, social, and cultural development plan of the Islamic Republic of Iran (1995-1999) is the most important document on economic and public administrative reforms. The law utilizing experiences of the First Plan and the favorable conditions it provided, stipulates more comprehensive regulations on economic and administrative reform. Further elaboration on the Second Plan will come in the next section. Qualitative Macro goals of the Second Plan concerning administrative reform are as follows:

1. Enhancing productivity

2. Providing for sustainable economic growth and development centered on the expansion of agriculture

3. Improving the country’s monitoring, administrative, executive and judiciary structures

4. Strengthening participation by the general public and adopting necessary measures for appropriate and continuous monitoring of the implementation of the plan

5. Reducing economic dependence on oil revenue and ensuring greater expansion of non-oil exports.

6. Balancing the three major economic sectors (Cooperative, private and public).
Administrative Reforms

Characteristics of the Iranian economy, problems and the necessary reforms were discussed in the preceding section. Public administration and related problems were also discussed in this section. Administrative reforms will be discussed including past and future efforts. According to the laws and regulations approved, these reforms are well tuned to help the economic transformation. The most remarkable issues are as follows:

**Elimination or Reduction of Bureaucracy Through Limiting of State Organization**

Heavy burden reduces dynamism and effectiveness of the state in handling its affairs. Reflections on economic events and changes in the late 80s and early 90s show that bureaucratic reduction, as well as the assumption of a new role by the state as policy-maker and coordinator are effective factors in the development process. In fact, there are common attributes responsible for economic reconstruction in different countries.

Considering the extension of public administration in Iran, limiting measures were taken even during the war period. Hence, several laws and regulations have been approved in this regard. After the end of war, the Ministry of the Islamic Revolution Guards Corps was integrated into the Ministry of Defense, and the Ministry of Heavy Industry was integrated into the Ministry of Industry. The dissolution of import monitoring institutes that had created a lot of problems in import affairs was a positive decision. Integrating or dissolution of state agencies is stipulated in the budget law every year. Also, the Council of Ministers has privatized public corporations or companies under the auspices of the state. In the First Plan, there were rules to limit public administration. In the Second Plan, the following rules were specified: (1) scaling down the size of the public sector through organizational restructuring, integration of parallel ministries, organizations and public companies and transfer of some public activities to the private and cooperative sectors, (2) reforming the organization of ministries, state agencies, and public companies with the aim of transferring affairs to the private and cooperative sectors, (3) reforming the organization of the state with the aim of reducing public expenditures, (4) transferring state companies to the private and cooperative sectors, and (5) elimination of state monopolies.

**Developing the Private and Cooperative Sectors and Attracting Public Participation**

A prior outcome of limiting public administration is the provision of favorable grounds for private activities and public participation. Compared to most countries, the process of privatization started rather late in Iran, and it has progressed somewhat slowly. However, no comprehensive regulation on privatization has been approved and no specific state agency has been charged with the task of encouraging privatization and public participation. The Second Plan, concerning the same subject, provides for: (1) strengthening legal protection and providing facilities for more participation by the people in economic, social
and cultural activities and emphasizing the necessity of attracting private and cooperative investment, (2) extending efforts towards constancy and stability in the laws and regulations relating to the activities of the private and cooperative sectors; (3) taking steps to increase the share of the private and cooperative sectors in the country’s gross domestic product, and (4) transferring responsibility for some services to the municipalities.

The Administrative High Council

As was mentioned, the Administrative High Council, which was established by the First Plan, is the sole agent with vast powers of administrative reform. Continuance of the Council’s incumbency was stipulated in the Second Plan. The Administrative High Council consists of a number of ministers, the chief of the Plan and Budget Organization, three individual experts, the Director General of the SOAE, and two deputies from Majlis. The President of the Islamic Republic of Iran heads the Council. The Council was vested with more powers in the Second Plan. Some of them are: (1) Administrative reform with regard to organization, systems and procedures, and manpower management, (2) Handing over part of duties and functions of state agencies to the private sector, (3) Studying, revising, and decision-making concerning integration, dissolution, or continuance of state companies, (4) Approving necessary criteria on the improvement of composition and distribution of manpower in the state agencies, (5) Approving necessary schemes to promote efficiency and management of the state agencies, (6) Improving special working methods, administrative (general) working methods, and interorganizational working methods; (7) Revising duties and organizations of Ministries, state agencies, and state companies by integrating and dissolving them when necessary.

Reduction of the Country’s Dependence on Oil Revenue and Expansion of Non-oil Exports

Dependence on oil revenue has served as detriment to the Iranian economy, as a result of which the import substitution policy has been carried out for years. After the end of the imposed war and commencement of reconstruction and reform activities, the policy of export expansion, particularly industrial exports, to substitute oil revenue was adopted. There are regulations in the First and the Second plan in this regard, such as: (1) Optimal utilization of the country’s existing taxation capacities, (2) Several amendments of regulations to facilitate exports, (3) Establishment of an Export Development Bank and state agencies to encourage exports, (4) Coordinating and mobilizing state agencies to expand exports, and (5) Establishing and encouraging export unions and cooperatives.

Improvement of Management and Manpower in Public Administration

A top priority in administrative reform in Iran is the improvement of state management and manpower. There is a long list of measures taken to achieve this aim. Some of them in the Second Plan will be mentioned here: (1) Promoting a culture of hard work and
production and reinforcing a sense of industriousness with a view to increasing the productivity of the country’s manpower, (2) Putting emphasis on the training and selection of competent and efficient managers, and monitoring their performance, (3) Reforming the country’s wage and salary system, (4) Improving the composition of the country’s manpower by increasing the ratio of people to those engaged in support and service activities, (5) Revising the management structure of public companies, (6) Formulating and implementing an effective system for the selection and evaluation of managers, (7) Instituting a precise system of performance evaluation and efficiency measurement in the country’s administrative structure, and (8) Setting up an effective system of reward and punishment dispensation to increase efficiency.

Research Development and Technology Transformation

Research development and technology transformation as an instrument to solve development problems are emphasized in the Second Plan, and public administration is dutybound to realize the policy by: (1) Developing a research system conducive to further enhancement, better arrangement and coordination of research activities and their evaluation, (2) Setting research priorities, (3) Strengthening relations between the country’s research centers and their international counterparts, and (4) Reinforcing an organic relationship between research application and education.

Establishment of Free Trade Zones

In 1993, the government of Iran established three major free trade zones in Queshm, Kish, and Chahbahar, the first two being islands in the Persian Gulf, while the third zone is located in the extreme southeastern port, on the Sea of Oman. Attraction of domestic and foreign investment to establish manufacturing and industrial units with the aim of industrial export expansion has been the main objective in establishing these zones. The advantages of the free trade zones for investing are as follows: (1) Open to domestic and foreign investments and partnership on any scale and division, (2) 15-year tax holiday, (3) Foreign and domestic bank loans and facilities, (4) Free entry, transfer, and repatriation of capital, (5) Access to the various sources of energy such as gas, crude oil, petrochemicals, and skilled labor, (6) No visa requirement for foreigners, and (7) Access to international waters through the Persian Gulf, the Sea of Oman, and the Indian Ocean.

Conclusion

Fair and efficient governance is both a valuable aim and instrument of economic development. Since development is essentially a political issue, it is inconceivable to build fair governance in the absence of a political regime and a state capable of establishing and supporting it. Western-type liberal regimes based on market economy are not necessarily the only political regimes which are capable of playing the role of catalyst for development.
Comparative studies of the countries that have recently joined the circle of the developed countries, indicates that they are not politically in conformity with western patterns of government. On the contrary, they are characterized by a set of common attributes that distinguish them as development-oriented states. The Islamic Republic of Iran, though encumbered by political and economic problems, is politically a development-oriented regime. The economic and administrative problems inherited, as well as the entanglements of the revolution itself and nine years of war have brought about severe economic and administrative difficulties.

In recent years, considering Iran’s economic and administrative entanglements, a set of administrative reforms to facilitate economic development have been duly studied and applied by the state. The administrative policies adopted include: limiting state organization, functions and responsibilities; developing the non-governmental sector, and attracting public participation; establishing the Administrative High Council as the administrative reform authority; reducing the dependence on oil revenues, and developing exports; improving state management and manpower; developing research and transferring technology; and finally, establishing well selected free trade zones. The complete execution of these reforms are expected in the near future.

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