

Restructuring Banking System in Iran

بازسازی نظام بانکی در ایران

JAVAD KASHEFI, PHD

Table of Content

Executive Summary	Page 3
Current Banking System in Iran- Introduction	Page 3
Current Central Bank of Iran	Page 3
Restructuring Central Bank of Iran	Page 5
Organizational Structure of the Banking System in Iran	Page 5
The Role of Banking System in the Eight Economic and Banking Districts	Page 7
A new regulatory body for the Central Bank of Iran.	Page 8
Regulation of Banking System in Iran	Page 8
Privatizations of Government Banks	Page 9
What will be the future of the banking system In Iran?	Page 11
Conclusion and Recommendations	Page 12

Executive Summary

The banking system in Iran is currently facing near bankruptcy due to a lack of liquidity, capital reserve, incompetency of the government, strict Islamic banking law, and economic sanctions. Apart from these conditions, Iran's banks may face other problems because they do not have unanimous rules in Islamic Banking without an "Interest Rate."

The banking system in Iran has faced significant challenges in recent years, and some of the factors that have contributed to these difficulties are listed below:

Lack of Liquidity: Iran's banking system has struggled with liquidity issues, partly due to the impact of economic sanctions. Sanctions have restricted Iran's ability to engage in international financial transactions and trade, making it difficult for the country to access foreign currency and maintain sufficient liquidity.

Capital Reserve: Capital adequacy is crucial for the stability of any banking system. If banks do not maintain adequate capital reserves, they may be more vulnerable to financial shocks and crises. Inadequate capital reserves can result from various factors, including non-performing loans and mismanagement.

Incompetency of the Government: Political and economic instability and issues related to governance and management can impact the overall health of a country's banking system. Government policies and actions can significantly influence the financial sector's stability and performance.

Strict Islamic Banking Law: Iran follows Islamic banking principles, prohibiting the charging or paying interest (riba). Instead, Islamic banks operate on profit and loss sharing (Mudarabah) and risk-sharing (Musharakah). While these principles align with Islamic finance, they can be complex and may pose challenges for traditional banking operations.

Economic Sanctions: International economic sanctions, particularly those imposed by the United States, have significantly constrained Iran's ability to engage in global trade and financial transactions. This has had a negative impact on the country's overall economic health, including its banking sector.

It's important to note that the issues facing Iran's banking system are interconnected and can have compounding effects. Efforts to stabilize and strengthen Iran's banking system may include creating a new national bank, improving transparency and risk management practices, dealing with non-performing loans, increasing capitalization, and promoting international cooperation to ease sanctions.

Current Banking System in Iran- Introduction

Banks in Iran can be categorized into two major groups: government-owned and private banks.

Government-Owned Banks: These government-owned banks offer a range of conventional banking services to the public and businesses, such as deposit accounts, loans, and other financial products.

Specialized Banks: Specialized government-owned banks focus on specific sectors or industries, such as agriculture or housing. They provide financial services tailored to the needs of these sectors and often play a crucial role in supporting economic development.

Private Banks: Private commercial banks in Iran operate under the principles of Islamic finance and offer services like government-owned commercial banks. However, they adhere to Islamic banking principles, which means they do not charge or pay interest (riba) and follow other Sharia-compliant financial practices.

Additional challenges that were imposed on Iran's banking system by the United States in 2018, was cutting off the entire Iranian banking system from SWIFT. The result of the sanction made Iran to join the banking system of the Russian state-owned VTB. This joint bank agreement allowed Iran to connect its national financial messaging service (SEPAM) to Russia's Financial Messaging System of the Bank of Russia (SPFS). Russia started developing SPFS when it was threatened with expulsion from SWIFT for annexing Crimea in 2014.

SPFS is the Russian equivalent of the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the global financial messaging and transfer system.

Current Central Bank of Iran

The Central Bank of Iran (CBI, *Bank-e-Markazi*) is a government organization that conducts the nation's monetary policy. The CBI was established in 1960 by Iran's first Monetary and Banking Act to issue currency and serve as the government's banker. The Second Monetary and Banking Act of 1972 expanded the CBI's responsibilities to include issuing currency, implementing monetary policy, and supervising the banks. According to this Act, the CBI's objectives were defined as follows:

- Maintaining the value of the currency
- Maintaining equilibrium in the balance of payments
- Facilitating trade transactions
- Assisting the economic growth of the country

The challenge of controlling inflation rate of 50% or more and stabilizing the economic cycle has indeed been a longstanding issue for the Central Bank of Iran (CBI) since the Islamic Revolution in 1979. The transition to an Islamic banking system in 1983 that adheres to Sharia principles, which prohibit interest-based transactions (riba), introduced unique challenges for the CBI in conducting monetary policy.

The government's chronic fiscal deficit has been directly or indirectly financed by issuing currency at par value and selling it at a premium instead of issuing government debt instruments has added an additional challenge for the bank to conduct its monetary policy.

The government has been unwilling (or unable) to collect tax from the bonyads (large quasi-private conglomerates), reduce energy subsidies, and borrow from the lenders in the market to fill in the budget gap, not only increased the money supply and hence inflation but also it represents a hidden regressive tax from all citizens.

In the past three years, the Central Bank has purposefully printed more money, and with more money in circulation, it reduces the "Rial" value because enough national wealth doesn't back it. It's also reported that some banks are not investing in the deposits accordingly. As a result, there are some banks on the verge of bankruptcy as they are listed below:

1. Ayandeh Bank بانک آینده
2. City Bank بانک شهر
3. Capital Bank
4. Parsian Bank بانک پارسیان
5. Day Bank بانک دی
6. Export Development Bank of Iran بانک توسعه صادرات ایران
7. Bank Meli of Iran بانک ملی ایران
8. Sepah Bank بانک سپه
9. Agricultural Bank بانک کشاورزی
10. Iran Land Bank بانک زمین ایران
11. Maskan Bank بانک مسکن
12. Cooperative Development Bank بانک توسعه تعاون

Restructuring the Central Bank of Iran

Restructuring the Central Bank of Iran is a complex and multifaceted process that requires a comprehensive approach involving legal, organizational, and operational changes. The specific steps and strategies for restructuring would depend on the goals and objectives of the restructuring effort and the economic and political context in Iran. Below is a general framework that should be considered when restructuring the Central Bank of Iran:

Define Objectives and Goals:

Identify the specific goals and objectives of the restructuring. This could include improving monetary policy effectiveness, enhancing financial stability, promoting economic growth, or addressing governance issues.

Legal and Regulatory Framework:

Review and update the legal and regulatory framework governing the central bank's operations. Ensure that the central bank has operational independence and is equipped with legal authority to carry out its mandate effectively.

Governance and Accountability:

Strengthen governance structures and enhance transparency and accountability. This may involve reforms in the central bank's decision-making processes, appointment mechanisms for top officials, and disclosure requirements.

Operational Independence:

Ensure that the central bank is shielded from political interference and has the autonomy to formulate and execute monetary policy independently.

Monetary Policy Framework:

Evaluate and potentially revise the monetary policy framework to make it more effective in achieving price stability and other macroeconomic objectives. Consider adopting inflation targeting or a similar framework.

Financial Stability:

Enhance the central bank's role in safeguarding financial stability by improving supervision and regulation of financial institutions, monitoring systemic risks, and developing crisis management tools.

Reserve Management:

Review and optimize the management of foreign exchange reserves to ensure their adequacy and prudent investment.

Payment Systems and Technology:

Upgrade the payment and settlement systems to promote efficiency and security in financial transactions. Embrace modern technology to improve the central bank's operations.

Human Resource Development:

Invest in the training and development of central bank staff to ensure they have the necessary skills and expertise to carry out their functions effectively.

Communication Strategy:

Develop a clear and effective communication strategy to convey the central bank's policies and actions to the public, financial markets, and the government.

International Collaboration:

Collaborate with international organizations and other central banks to benefit from best practices and technical assistance.

Public Awareness and Education:

Educate the public about the central bank's role and its importance in the economy to build trust and support for its policies.

Monitoring and Evaluation:

Establish mechanisms for ongoing monitoring and evaluation of the central bank's performance and the effectiveness of the restructuring efforts.

Finally, as the Central Bank of Iran, the Bank is responsible for conducting national monetary policy to achieve full employment and price stability among the eight bank and economy districts in Iran. With its monetary policy, the Central Bank can influence the state of the economy in the following ways:

First, the Central Bank of Iran (CBI) can play a crucial role in influencing the state of the economy through its monetary policy. One of the primary tools it uses is its influence on interest

rates, which, in turn, affects various aspects of the economy, including household spending. Here's a more detailed explanation of how CBI's monetary policy can impact the economy:

Second, monetary policy, through the Central Bank's control over interest rates, affects the cost of borrowing for businesses. Lower interest rates make borrowing cheaper and more attractive for businesses, encouraging them to invest in expansion, equipment, and hiring.

By its effect on the amount of spending by households and businesses, monetary policy influences the aggregate demand for products and services. It, therefore, affects the national income level and employment level. Since the aggregate demand can affect the price level of products and services, the Central Bank indirectly influences the price level and hence the inflation rate.

Third, collaborating with district-level banking and economic systems allows for a more targeted approach to regional economic development. Different districts may have unique economic strengths, challenges, and opportunities. By working closely with district banks and economic entities, the CBI can tailor its policies and initiatives to address the specific needs and priorities of each region, potentially fostering local economic growth.

Organizational Structure of the Districts Banking and Economy System of Iran

Economic equity and equality should be the cornerstone of government policy among provinces. Most of the past economic activities based on Gross Domestic Product (GDP) have centered on the province of Tehran and Khuzestan (Table 3). According to *Donya-e-Eqtasad*, between 2017 and 2019, 11 of the 20 poorest Iranian cities were in the province of Sistan and Baluchestan. Three other markedly poor cities were in Kerman province.

The Kharazmi Group proposes to the new government of Iran to establish eight districts (as shown in Table 2).

District -1	District-5
West Azerbaijan	Golestan
East Azerbaijan	North Khorasan
Ardabil	Razavi Khorasan
Gilan	South Khorasan
District-2	District-6
Kermanshah	Esfahan
Kurdistan	Yazd
Hamadan	Chaharmahal and Bakhtiari
Zanjan	Kohgiluyeh-Buyer Ahmad
District-3	District-7
Qazvin	Illam
Markazi	Khuzestan
Lorestan	Bushehr
Alborz	Fars
District-4	District-8
Mazandaran	Hormogan
Tehran	Kerman
Qom	Sistan-Baluchistan
Semnan	Transregional



We can establish eight banking and economic systems using the eight districts (Table 2). These eight banking and economic districts could be established based on criteria such as region, competencies, or unique aspirations, primarily focusing on fostering collaboration and unity among participants to achieve common objectives. What is paramount is the mandate for broader collaboration and unity to reach common objectives. These objectives should be achieved organically, as much as possible, without the need for mandates or governing body interference. The Kharazmi Group proposes establishing a banking and economic district based on each province's population and GDP distribution, as shown in Table 3.

The proposal to establish eight banking and economic districts based on GDP will foster collaboration and economic development across different provinces in Iran. It aligns to promote economic equity and equality among provinces, as well as encourage organic collaboration to achieve common objectives.

District -1	GDP	Population	District-2	GDP	Population
West Azerbaijan	2.0	3.6	Kermanshah	1.5	2
East Azerbaijan	3.5	4.1	Kurdistan	0.9	1.7
Ardabil	1.0	1.3	Hamadan	1.2	1.8
Gilan	2.2	2.6	Zanjan	1	1.1
GDP Contribution	8.7	11.6	GDP Contribution	4.6	6.6
District-3	GDP	Population	District-4	GDP	Population
Qazvin	1.5	1.4	Mazandaran	3.3	3.5

Markazi	1.9	1.5	Tehran	22.1	14.4
Lorestan	1.1	1.8	Qom	1	1.4
Alborz	2.8	3	Semnan	0.9	0.8
GDP Contribution	7.3	7.7	GDP Contribution	27.3	20.1
District-5	GDP	Population	District-6	GDP	population
Golestan	1.2	2.0	Esfahan	5.5	5.5
North Khorasan	0.5	0.9	Yazd	1.8	1.3
Razavi Khorasan	4.9	7.2	Chaharmahal and Bakhtiari	0.9	1
South Khorasan	0.5	0.9	Kohkiluyeh-Buyer Ahmad	2.2	0.8
GDP Contribution	7.1	11.0	GDP Contribution	10.4	8.6
District-7	GDP	Population	District-8	GDP	Population
Illam	1.2	0.6	Hormogan	2	2.1
Khuzestan	14.8	5.1	Kerman	3.1	3.5
Bushehr	6	1.3	Sistan-Baluchistan	1.4	3.3
Fars	4.7	5.2	Transregional	1.6	0.5
GDP Contribution	26.7	12.2	GDP Contribution	8.1	9.4

Source- Statistical Center of Iran-2022

Organizing banking and economic districts based on population and GDP distribution can help ensure that regions with different levels of economic development work together towards common goals.

Each district can focus on regional challenges and opportunities, leveraging the strengths and resources of the provinces within it. The use of GDP and GDP per capita in this context has several merits:

- a. **Economic Prosperity Assessment:** GDP per capita is a monetary measure of economic prosperity on a per-person basis. It helps assess the standard of living and wealth distribution within a district. A higher GDP per capita generally indicates a higher level of economic well-being for the residents of that district.
- b. **Resource Allocation:** Districts with higher GDP per capita often generate more tax revenues and economic activity. Therefore, they may require different levels of government services and infrastructure development compared to districts with lower GDP per capita. Allocating resources based on economic indicators ensures that districts receive the necessary investments to maintain and improve their economic conditions.
- c. **Policy Evaluation:** By analyzing GDP, and GDP per capita, data at the district level, policymakers can assess the effectiveness of their economic policies. If certain districts consistently lag in terms of economic growth (as indicated by low GDP per capita), it can signal a need for policy adjustments, or targeted interventions.
- d. **Equity & Inequities:** Using these economic metrics helps identify disparities in wealth and income across districts. Policymakers can then implement policies to reduce

economic inequities and promote a more equitable distribution of resources and opportunities.

As shown in Table 3-a, Districts 4, 6, and 7 have notably higher GDP per capita values than the rest of the districts. This indicates that these districts are more economically prosperous or have experienced significant economic growth per person compared to the others.

Table-3-a	GDP Per Capita		GDP Per Capita
District -1	0.750	District-2	0.697
District-3	0.948	District-4	1.358
District-5	0.644	District-6	1.209
District-7	2.189	District-8	0.862

The central government's economic policies have played a major role in these disparities, but other local and regional factors or long-range national priorities can also be significant contributors. However, it's important to note that the reasons for these variations can be complex and multifaceted. Economic performance is influenced by various factors, including government policies, infrastructure, education, industry composition, availability of natural resources, inherent risks/liabilities, and historical development patterns.

Addressing economic disparities between districts often requires a comprehensive approach considering national and regional factors, including policy adjustments, targeted investments, and efforts to promote economic growth in less prosperous areas.

The Role of Banking System in the Eight Economic and Banking Districts.

The establishing district central banks, commercial banks, and savings institutions in each province, as proposed in Table 4, can have significant advantages in fostering regional economic growth and prosperity. This decentralized approach can help channel resources and financial services to local businesses and consumers, leading to positive economic outcomes for the districts. Here are some key benefits and considerations:

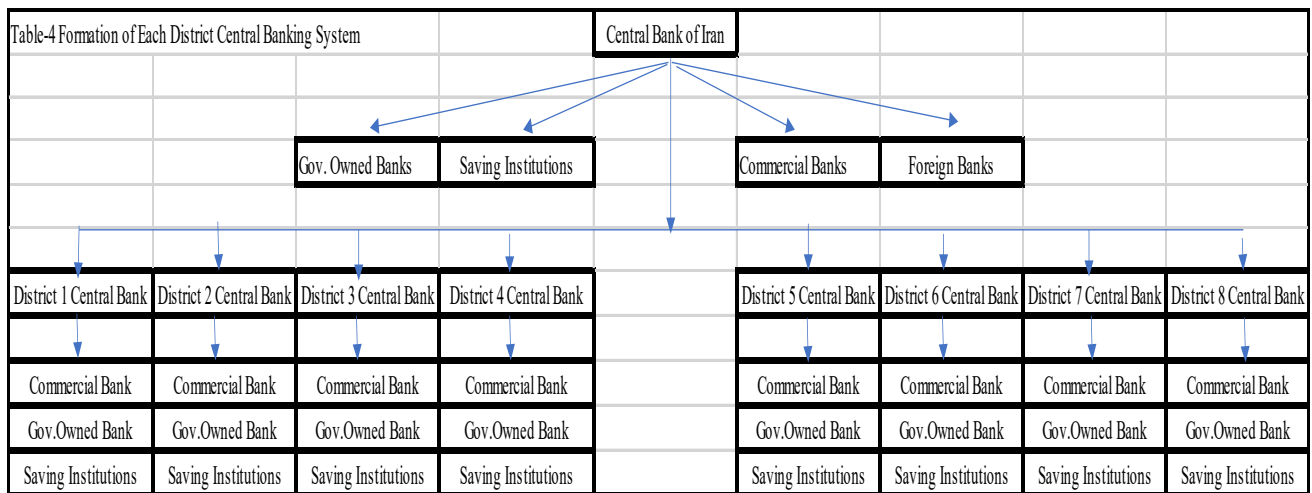
- 1. Local Economic Focus:** District central banks, commercial banks, and savings institutions can have a strong local focus, tailoring their services to the specific needs of the province and its communities.
- 2. Increased Access to Finance:** Local banks and savings institutions can improve access to financial services for businesses, entrepreneurs, and individuals in underserved or rural areas.
- 3. Regional Economic Development:** These institutions can play a pivotal role in supporting local businesses, promoting entrepreneurship, and driving economic development within the district.
- 4. Job Creation:** These institutions can contribute to job creation and lower unemployment rates by providing funding and financial support to local businesses.

5. Community Investment: District banks may prioritize investments in local infrastructure, community projects, and social programs, further strengthening the district's economic and social fabric.

6. Efficient Resource Allocation: Local financial institutions can better understand the province's economic landscape and allocate resources more efficiently to areas with growth potential.

7. Local Expertise: Local banks can tap into local expertise and networks, facilitating relationship-based lending and fostering trust between banks and businesses.

8. Financial Inclusion: Savings institutions can encourage savings and financial inclusion among the local population, helping people build financial stability and security.



The strategy of establishing district central banks in each province to support regional prosperity and economic growth has the potential to be a powerful tool for promoting economic development and improving the welfare of the people in each district.

Establishing District Central Banks (DCBs) in each province could indeed have several potential benefits for regional prosperity and economic growth. However, it's important to note that this idea would require careful planning, regulation, and oversight to ensure its effectiveness and avoid potential downsides. Here are some key points to consider:

Localized Economic Focus: DCBs can focus on their respective regions' specific economic needs and challenges. This allows for tailored monetary policy and financial support that can more effectively address local issues.

Support for Local Businesses: DCBs can play a vital role in providing financial support and resources to local businesses. This could include access to credit, grants, and assistance with business development, all of which can stimulate entrepreneurship and job creation.

Consumer Welfare: DCBs can also prioritize the financial well-being of local consumers by offering banking services and promoting financial literacy programs. This can help improve financial inclusion and reduce poverty.

Regional GDP Growth: By addressing the unique economic conditions and opportunities of each district or province, DCBs can contribute to higher GDP growth rates in those areas. This, in turn, can benefit the overall economy.

Local Decision-Making: DCBs can be more attuned to local economic conditions and have a better understanding of regional economic trends. This can result in more effective policy decisions that benefit the local economy.

Risk Management: DCBs can help mitigate regional economic risks by closely monitoring and responding to economic developments in their areas. They can act as a buffer against economic shocks.

However, there are also challenges and potential downsides to consider:

Coordination and Regulation: Establishing multiple DCBs requires a robust regulatory framework and coordination between different levels of government. Ensuring that DCBs operate effectively and do not engage in risky behavior is crucial.

Resource Allocation: Distributing resources among different provinces or districts could be a complex task, and misallocation may occur if not managed carefully.

Political Interference: There's a risk that DCBs could become subject to political pressure, which may affect their ability to make sound economic decisions.

Economic Disparities: While DCBs aim to uplift regional economies, there's a possibility that they may exacerbate economic disparities if not managed carefully.

Efficiency and Cost: Establishing and maintaining multiple DCBs may be expensive and could potentially be less cost-effective than a centralized banking system.

In conclusion, the establishment of District Central Banks (DCBs) has the potential to support regional prosperity and economic growth by addressing localized economic needs and fostering economic development. However, it's essential to carefully consider the regulatory framework, resource allocation, and potential challenges to ensure the success of such a system. Additionally, a balance must be struck between regional autonomy and central oversight to prevent mismanagement and political interference.

Each local commercial Bank and saving institution in that region will become a member of the District Central Bank and will buy the stock of the District Central Bank. The proposed partnership among local commercial banks and savings institutions become members of the District Central Bank and actively participate in its governance and operations, can foster a collaborative and regionally focused approach to achieving economic goals, including a low inflation rate and full employment. While focusing on regional goals, the District Central Bank

should also align its strategies with the broader national economic objectives, such as low inflation and full employment, to ensure consistency with overall policy goals.

The District Central Bank will elect nine supervisory board members from the local commercial banks and saving institutions to manage each bank's liquidity, assets and liabilities, and risk exposure.

Develop a new regulatory body for the Central Bank of Iran.

Bank regulations are designed to maintain public confidence in the financial system by preventing banks from becoming too risky or bankrupt. In this part, we present the regulatory structure banking system in Iran which will be different from current Islamic banking that is on the verge massive default by commercial banking and saving institutions.

The National Supervisory Banking Board

The National Supervisory Banking Board comprises eight chairs of each districts supervisory board, the head of the Economic and Finance Ministry, and a chairman of the National Supervisory Banking Board, who the Prime Minister appoints. The tenure of these members is set for ten years to reduce political pressure.

The National Economic Committee

The National Economic Committee comprises the National Supervisory Banking Board members plus the Prime Minister's economic advisor. The main goals of the National Economic Committee are to achieve stable economic growth and price stability- low inflation. Achieving these goals would stabilize financial markets and preserving the value of Iran's currency (Rials) against other currencies.

Regulation of Bank System in Iran

The regulatory structure of the new banking system will be different from the Islamic banking system. All commercial banks and saving institutions must acquire a license (permit) from the District and National Supervisory Banking Board to operate. All commercial bank saving institutions should provide evidence of the need for their services and should disclose how they will benefit the economy of the district. Both district and the National Supervisory Banking boards determine if they satisfy procedures and policies to qualify for the operation.

The National Supervisory Banking Board must establish the following regulations:

1. Deposit Insurance

Banks should be regulated according to how they obtain and use their funds and the types of services they can offer.

Banking services must focus on the safety and security of depositors'/savers' funds. Iranian consumers have been largely more cautious due to the social, economic, and political tumult over the last four decades. The National Supervisory Banking Board must establish deposit insurance, the amount of insurance, and the limit of the insurance for the banking system to earn public confidence in Iran's banking system.

In general, deposit insurance allows depositors to deposit funds under the insured limits in any insured depository banking system without assessing the bank's financial condition.

2. Regulation of Bank Loans

Loans are a bank's critical asset, and they need to be regulated to limit its exposure to default risk.

a. **Regulation of Highly Leveraged Transactions.** The National Supervisory Banking Board should monitor the amount of highly leveraged transactions in which the borrower's liabilities are valued at more than 60% of total assets.

b. **Regulation of Loans to a Single Borrower.** Banks are restricted to a maximum loan amount of 15 percent of their capital to any borrower (up to 25 percent if the loan is adequately collateralized), which forces them to diversify their loan portfolio.

c. **Regulation of Loans to Community.** Banks should also be regulated to ensure that they accommodate the funding needs of the communities in which they operate. The regional supervisory banking committee should require banks to meet the funding needs of qualified borrowers in their community, even those with low or moderate income.

d. **Regulation of Foreign Loans.** The National Supervisory Banking Board should also monitor a bank's exposure to loans to foreign countries. This requirement allows banks to disclose their loan exposure to foreign countries' risk, which is viable information for depositors and investors.

3. Regulation of Capital

Banks are subject to capital requirements, which force them to maintain a minimum amount of capital as a percentage of total assets. They rely on their capital as a cushion against possible losses. If a bank has insufficient capital to cover losses, it will be unable to cover its expenses and fail. Banks need to boost their capital levels with earnings commensurate with the risk of

their asset portfolio. A bank could charge a risk-based interest rate to mitigate the default risk. However, this is not the case in Iran, and many banks need more capital to meet the depositor's cash withdrawals.

Privatizations of Government Banks

The inclination to privatize banks stems from the fact that the current Islamic banking system has not been able to enhance the life of Iranian people and, on the contrary, has damaged the country's financial stability. With its rich natural resources, Iran has yet to achieve higher economic growth and low inflation. The current inflation rate is about 53%, and a negative GDP over the last few years.

Many policymakers in different countries at all stages of development have opted for bank privatization over the last 25 years, reflecting a growing consensus that government-owned banks are less desirable than privately owned banks—source- Recent Trend in Bank Privatizations, World Bank Group, July 2020.

Most of the bank privatizations often occur during or shortly after political or banking crises. bank privatizations are frequently part of a more general trend in a country and, thus, generally share many of the same objectives as privatization. In most countries, some, or all the following objectives have motivated privatization, which in many cases have specific considerations for state-owned banks.

- **Raise revenues for the state.** The importance of privatization revenues extends well beyond development and transition economies. Privatization revenues have been important for some countries seeking to meet the Maastricht criteria. British privatization proceeds in the 1980s substantially reduced government debt.

- **Promote economic efficiency and reduce government interference in the economy.** Government ownership often has not been effective in meeting development goals. Policymakers may expect privatized enterprises to be more responsive in meeting consumer demand. Efficiency gains can eliminate the need for subsidies, freeing up fiscal resources for other priority spending or debt reduction.

The potential fiscal burden of subsidizing the credit and operating losses inefficient state-owned banks can provide political motivation for privatization, as even substantial costs to clean up a bank's balance sheet to make it attractive to investors may be less burdensome than continuing subsidies. A more efficient banking system will benefit the economy overall by reducing the costs of intermediation.

- **Promote wider share ownership.**

Initial public offerings (IPOs) are a frequent means of privatization, with provisions such as shares being sold in small allotments or restrictions on foreign participation commonly being used to promote ownership by individual domestic investors. These provisions are frequently viewed as a tool to promote the development of capital markets. However, policymakers often

prefer a strategic partner to acquire a controlling or significant interest as the bank is divested, as opposed to widely dispersed ownership, particularly where there are concerns about the quality of management and systems of a state-owned bank.

- **Provide the opportunity to introduce competition.**

In some of the former socialist countries, such as Russia and Poland, large state-owned banks were transformed into several smaller banks before or during privatization. Using privatization to encourage foreign bank entry can lead to an overall enhancement of management skills in the banking sector.

- **Subject state-owned enterprises to market discipline.**

Privatizing banks can be particularly helpful in achieving this objective, as private banks are less susceptible to moral suasion or explicit directives to provide preferential financing to state-owned enterprises. Thus, bank privatization may help to improve the efficiency of other state-owned enterprises as they would have to be able to obtain credit on commercial terms rather than relying on the support of state-owned banks.

The evidence of many bank privatizations in a diverse array of countries makes it clear that policymakers believe that it does matter whether the government owns banks. While there may not be conclusive empirical evidence of causation, state-owned banks are associated with “bad” growth and development outcomes. These can be attributed to inefficiency on the part of state-owned banks or, less benignly, to political interference. Even if lacking empirical proof, many policymakers have concluded that private sector banks are more efficient, and privatization removes the irresistible cookie jar of state-owned bank largess from the reach of politicians. Thus, the trend of privatization of state-owned banks is likely to continue. Source- State-Owned Banks, Stability, Privatization, and Growth: Practical Policy Decisions in a World Without Empirical Proof. IMF Working paper.

Methods of Privatization

Most bank privatizations take some form of the share sale, with phased privatization often involving first an IPO or private placement, followed by subsequent secondary offerings. Privatization is a process, not an event, so while it is common to categorize by type of transaction, many decisions lead to the final choice about divesting the government’s ownership stake. Policy objectives and political and fiscal constraints influence these decisions. A widely subscribed IPO can be politically attractive as a means of preserving domestic ownership, avoiding the pitfalls of lending to parties connected to significant bank owners, and may also serve to foster capital market development by providing an extensive listing for the stock exchange.

What will be the future of the banking system In Iran?

Predicting the future of a country's banking system is complex and influenced by a wide range of factors including political, economic, technological, and social changes. Here are some potential directions the Iranian banking system could take:

- **Modernization and Digitization:** The banking system in Iran, like in many countries, could continue to modernize by embracing digital technologies. This might include the expansion of online banking services, mobile apps, and digital payment solutions.
- **Financial Inclusion:** Efforts to enhance financial inclusion could lead to greater access to banking services for underserved populations, including those in rural areas and low-income communities.
- **Enhanced Regulations:** Regulatory reforms might be implemented to strengthen the banking sector's governance, risk management, and transparency. These measures could improve the overall stability and reliability of the system.
- **Financial Technology (Fintech) Integration:** Fintech startups and innovations could play a role in shaping the banking landscape by introducing new ways of delivering financial services, such as peer-to-peer lending, mobile wallets, and blockchain-based solutions.
- **Access to International Markets:** Improvements in diplomatic relations and international sanctions could open doors for Iranian banks to reintegrate with global financial markets, allowing for cross-border transactions and investments.
- **Sustainable Finance:** There could be an increased focus on sustainable banking practices, including environmentally responsible lending and investing, as well as adherence to international sustainability standards.
- **Economic Diversification:** A diversified economy could lead to a more diversified banking system, offering a wider range of financial products and services to cater to different sectors and customer needs.
- **Strengthening Risk Management:** Lessons from past economic challenges could lead to improved risk management practices to prevent the accumulation of bad loans and ensure stability.
- **Government Policy Changes:** The direction of the banking system could be influenced by the economic policies and priorities of the government in power.
- **Global Economic Context:** Iran's banking system could be impacted by global economic trends, including changes in oil prices, global trade dynamics, and geopolitical factors.
- **Demographic Shifts:** Changes in demographics, such as an increasing young population, might drive the demand for innovative banking services and digital solutions.
- It's important to approach these possibilities with caution, as the future is inherently uncertain. The actual direction of Iran's banking system will depend on how these factors interact and the decisions made by government authorities, financial institutions, and other stakeholders. To gain a more accurate understanding of the future of Iran's banking system, staying informed about economic developments, policy changes, and emerging trends will be essential.

Conclusion and Recommendations

The question of how state-owned banks and their privatization affect financial sector stability and growth will continue to be an essential issue for the new government in Iran. There is a need for a balanced approach between government-owned and private banks, which must foster financial stability and higher economic growth.

As has been stated, the main concern here is the stability of the banking system and how the banks need to be responsible for the demand of depositors as part of the restructuring banking system; there is a need for a sound and strong national and regional supervisory committee.

A healthy national banking system will help long-term economic growth with stable prices and inflation. Below are some recommendations for the new government in Iran:

- a. **Strengthen Regulatory Framework:** Create a National Supervisory Banking Board regulatory framework governing the banking sector to ensure better oversight, transparency, and accountability. This includes creating strict regulations on capital adequacy, risk management, and anti-money laundering measures.
- b. **Risk Management Board:** Implement robust risk management regulation within banks to minimize the occurrence and impact of financial crises. Banks should conduct thorough risk assessments and stress tests and adopt effective risk mitigation strategies.
- c. **Implementing Corporate Governance:** Creating corporate governance practices within banks, including independent board members, transparent decision-making processes, and proper checks and balances. This will help prevent conflicts of interest, improve risk management, and enhance accountability.
- d. **Promote Financial Inclusion:** Facilitate access to banking services for underserved populations, particularly in rural areas and low-income communities. This can be achieved by establishing branch networks, mobile banking solutions, and financial literacy programs.
- e. **Enhance Technology Infrastructure:** Modernize the banking system's technological infrastructure to improve efficiency, security, and customer experience. This includes upgrading core banking systems, implementing robust cybersecurity measures, and developing user-friendly digital banking platforms.
- f. **Foster Competition:** Encourage competition within the banking sector by promoting the entry of new players and reducing barriers to entry. This can lead to better services, innovative products, and competitive customer interest rates.
- g. **Develop Credit Information Systems:** Establish comprehensive credit information systems that enable banks to make informed lending decisions and assess creditworthiness accurately. This will help reduce non-performing loans and improve overall lending practices.
- h. **Enhance Financial Education:** Promote financial literacy among the general population to ensure individuals understand banking products,
- i. **Strengthen International Collaboration:** Foster collaborations and partnerships with international financial institutions and regulatory bodies to benefit from best practices, technical assistance, and knowledge sharing. This can help align Iran's banking system with global standards and improve its credibility in the international financial community.
- j. **Combat Financial Crime:** Strengthen efforts to combat financial crimes, such as money laundering and terrorist financing, through rigorous enforcement of regulations and collaboration with law enforcement agencies. This will contribute to the overall stability and integrity of the banking system.

It is important to note that implementing these improvements may require significant time, resources, and cooperation among stakeholders, including government agencies, regulatory bodies, banks, and the public.