IRAN 1974 CONSULTATION

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MAR 17 1975

Sir:

I have pleasure in advising you that the Executive Board has taken the enclosed decision concerning the recent consultation with your Government under Article XIV, Section 4 of the Fund Articles of Agreement.

I should like to take this opportunity to express the Fund's appreciation for the courteous cooperation of your Government during the course of this consultation, and to say that the Fund looks forward to a continuation of this close relationship.

Very truly yours,

W. Lawrence Hebbard
Secretary

cc: Mr. Amuzegar
MED
LEG
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SEC

Enclosure

(Cleared with: Mr. Amuzegar, Mr. Gunter, Mr. Sturc.)

Governor
Bank Markazi Iran
P.O. Box 3362
Teheran, Iran

DR
DRoss:jmh - 3/13/75

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Mr. John Gunter

Room 3-314-C

(1) #4

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 75/29

10:00 a.m., March 12, 1975

H. J. Witteveen, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
J. Amuzegar	C. P. Caranicas
	J. H. Kjaer
L. B. Brand	
S. Y. Cross	C. R. Harley
	H. G. Schneider
N. Deif	M. Finaish
B. J. Drabble	
	A. Caram, Temporary
	C. L. A. Albuquerque
K. Kawaguchi	
B. Kharmawan	M. Shein
P. Lieftinck	T. de Vries
	J. K. E. Cole, Temporary
	J. L. Mora
E. Pieske	G. Laske
	W. M. Tilakaratna
	P. J. Bull
	G. Heyden Q., Temporary
J. H. Wahl	
	S. Nana-Sinkam

R. V. Anderson, Acting Secretary
D. H. Ross, Assistant

Also Present

R. Zeppernick, Special Trainee. African Department: M. Fiator. Exchange and Trade Relations Department: E. Elmholt, Y. Iura, T. Mookerjee, T. Sweeney. Fiscal Affairs Department: A. M. Abdel-Rahman, R. H. Floyd. Legal Department: J. G. Evans, Deputy General Counsel; G. P. Nicoletopoulos, Deputy General Counsel; R. C. Effros. Middle Eastern Department: J. W. Gunter, Acting Director; A. K. El Selehdar, Deputy Director; A. I. Abdi, B. Arnoot, R. C. Barth, A. Buira-Seira, M. T. Dajani, F. Drees, M. Edo, A. S. Gerakis, H. E. Jakubiak, A. Kayoumy, K. Nashashibi, D. B. Noursi, A. B. Petersen, A. S. Shaalan, S. K. R. Von Post. Research Department: J. J. Polak, Economic Counsellor and Director; J. M. Fleming, Deputy Director; M. Gurfinkel. Treasurer's Department: W. O. Habermeier, Treasurer; D. S. Cutler, D. Williams, G. Wittich. Western Hemisphere Department: J. Del Canto, Director. Information Office: I. S. McDonald. Personal Assistant to the Managing Director: D. W. Green. Advisors to Executive Directors: F. K. Hussein, A. Malek. Technical Assistants to Executive Directors: M. Berger, D. C. Chessell, J. A. Crosby, M. Danusaputro, A. Doizé, B. Goos, R. Khonsary, J. Lintjer, A. K. Mullei, A. B. Nymark, C. C. Ozumba, S. K. Panya, M. Pietinen, Z. Porath, F. Saccomanni, A. Takahashi, J. R. Vallet, M. A. Wasfy.

1. REPORT BY MANAGING DIRECTOR

The Managing Director, reporting on his discussions with the Venezuelan authorities concerning a possible contribution to the oil facility, stated that, as a result of the lower level of oil production and the decrease in oil exports, Venezuela, like other oil exporting countries, had substantially revised downward its estimated surplus on current account to between $1.3 billion and $1.5 billion. Although the authorities had large commitments for loans and aid, they had agreed to lend between SDR 200 million and SDR 300 million to the oil facility; the first SDR 200 million could be committed immediately, with the rest being made available if needed to achieve the SDR 5 billion considered necessary for the facility. With Governor Lafeé he had participated in a press conference at which the contribution had been made public.

In reply to a question by Mr. Bull, the Managing Director indicated that he would recommend that the Venezuelan authorities receive a rate of interest of 7.25 per cent.

Finally, the Managing Director commented that he hoped that papers relating to the 1975 oil facility would be available shortly, together with a paper reviewing the 1974 facility and a paper on borrowing agreements.

2. APPROVAL OF MINUTES

The draft minutes of Meeting 74/142 were approved.

3. IRAN - EXCHANGE SYSTEM AND 1974 ARTICLE XIV CONSULTATION

The Executive Directors considered a staff memorandum relating to the exchange system of Iran, together with the staff's analysis and recommendation (SM/75/48, 3/4/75) as well as a staff report and a proposed decision for the 1974 Article XIV consultation with Iran (SM/75/24, 1/29/75). The Executive Directors also had before them a report on recent economic developments in Iran (SM/75/37, 2/12/75).

The Acting Director of the Middle Eastern Department commented that the staff had not yet revised its estimate of the Iranian balance of payments in light of the recent decline in the level of oil production. The revision would be undertaken during the special consultations scheduled for April.

Mr. Amuzegar made the following statement:

> The Iranian economy continued to grow at an enviable pace during 1973/74. Real gross domestic product increased by 13.5 per cent, up

from 12.9 per cent during the previous year. Consumption increased by 11 per cent, while gross domestic capital formation grew by more than 18 per cent. The output expansion convered most sectors of the economy. The oil sector's real value-added increased by 15.6 per cent; industrial and service sectors grew at rates of 18.9 per cent and 14.6 per cent, respectively; value-added in agriculture rose by an estimated rate of 5.8 per cent, as compared with a 3.4 per cent average annual growth rate during the Fourth Plan (1968/69 - 1972/73).

The petroleum sector continues to play a predominant role in the Iranian economy. In 1973/74 it provided 64 per cent of total government revenues and 81 per cent of foreign exchange receipts. These shares are expected to increase to 87 per cent and 93 per cent, respectively, in 1974/75 due to increases in both production and oil prices. Iran is also making increasing use of its vast natural gas resources (estimated to be about 13 per cent of the world's total proven reserves) both for domestic and export purposes. In 1973, the foreign exchange receipts from this source of energy were about SDR 70 million, and have more than doubled during the first half of 1974.

In the light of 1973/75 developments in oil prices Iran's Fifth Development Plan (1973/74 - 1977/78) has been totally revised. The size of the Plan has more than doubled from the original $32 billion to nearly $70 billion. The revision is made possible--indeed necessary--by the dramatic new changes in Iran's future financial position and exchange earnings. The oil price changes and related developments had made planned outlays and resulting economic growth estimates virtually obsolete even before the current Plan got firmly under way. The original growth target of 11.4 per cent a year at constant (1972) prices is now expected to reach 26 per cent. Even disallowing the influence of terms of trade in the oil sector on the GNP growth, the implied real rate of GDP during the plan period will in the staff's calculation be no less than 14 per cent a year, on the average.

In the new draft, four basic considerations have been of paramount significance to the planners. First, financial and foreign exchange constraints, which previously limited the size of the Iranian plans, have been of minor significance. The planners have been able to aim at maximizing attainable growth targets. Second, since hitching the Plan's wagon virtually to a star has created new and different constraints, the planners' attention has focused on such production bottlenecks as inadequate skilled, technical, and professional manpower; insufficient infrastructure (for example, ports, roads, and railways); and shortages of natural resources, raw materials, minerals, and other inputs. Third, due care has been taken to closely coordinate the process of five-year planning with the annual budgetary exercise--a procedure which could not always be meticulously observed before. Finally the new Plan has been carefully tailored to present the first phase of a long-term, twenty-year, socioeconomic perspective.

The striking significance of the Fifth Plan's quantitative objectives and targets, however, cannot be truly appreciated without regard to the Plan's qualitative socioeconomic considerations. Thus it should be noted that in order to accelerate the rise in the standard of living of the people and to share the benefits of rising oil incomes with all socioeconomic strata, certain broad new social programs have been devised and are being introduced by the Government. These measures include free primary education, a nation-wide preventive health program, increased subsidies for basic foodstuffs, and a higher minimum income for workers.

The high level of domestic expenditures has inevitably increased domestic prices and inflated the cost of investment. But the authorities believe these to be a fair and unavoidable price to pay for their ambitious development objectives. The implementation of these socioeconomic programs, to be financed by increased revenues in the oil sector, has also naturally affected the Government's finances and public expenditures. Nevertheless, thanks to rising oil revenues, not only has there been a reduction in net financing from the banking system, but there has also been a reversal from considerable net external borrowing to a small net repayment in 1973/74. In the current fiscal year (1974/75), the further increase in the oil revenues has dramatically changed the fiscal picture, causing an increase of over 150 per cent in current expenditures and capital investment over the figures for 1973/74. Consequently, the overall budgetary position is expected to be in surplus by some Rls. 300 billion after a decade of continuous fiscal deficits.

As efforts are made to alleviate the pressure on domestic resources through liberalized import policies, the sharp rise in import prices and payments has contributed to the growth of expenditures, and has been reflected in higher subsidies for basic foodstuffs. In the fiscal year 1975/76, due to the expected slowdown in expansion of oil revenues, and an estimated 30 per cent increase in current and fixed capital expenditures, the surplus is anticipated to be much smaller than 1974/75. A broad-based tax reform to support the continued expansion of government financial operations in the future is under study.

In the monetary and credit area, the emphasis in 1973/74 continued to be on better liquidity management. Domestic liquidity expanded at the rate of 29 per cent last year, down from 35 per cent in 1972/73, as a result of appropriate measures taken by the Central Bank. These measures included an increase in the rediscount rates, an upward shift in the structure of interest rates on time and savings deposits, imposition of credit ceilings on commercial bank lending, a progressive raising of the required legal reserves on demand deposits (to 30 per cent by February, 1974), and introduction of marginal government bond purchase requirements on time and savings deposits.

The Bank Markazi's anti-inflationary programs which raised domestic interest rates by an average of 1.5 per cent on bank lending and imposed quantitative credit ceilings for commercial banks succeeded in keeping price inflation in check. In a recent move to give private investments a boost through lower interest rates, and to bring domestic rates more in line with international money rates, the Bank Markazi late in January 1975 authorized an expansion of credit and reduced interest rates for private industry, commerce, agriculture, and construction. The Bank Markazi's own rediscount rate was reduced from 9 per cent to 8 per cent, and allowed a reduction of lending rates by specialized banks by 2 per cent and for deposit money banks by one per cent. The ceiling on banking system credit to the private sector was increased, and legal reserve requirements were reduced. The new measures are designed to encourage private investment to meet the Fifth Plan's targets and to discourage speculative capital inflows following the downward movement in international money rates.

Prices, which had increased at the moderate rate of 6 per cent in 1972/73, accelerated to an average annual rate of 13 per cent last year, partly due to the increased import costs. Price pressures have continued during the first half of 1974/75. In order to reduce the impact of higher import prices domestically, price control measures and price stabilization programs, which had been initiated before, were supplemented by price subsidies for basic foodstuffs. Steps were also taken to expand the flow of imports at lower costs through the provision of increased credit for imports and a reduction of the import deposit requirements, import registration fee, and commercial benefit taxes for certain products. Rising prices, however, continue to be a major concern of the monetary authorities.

In the balance of payments for 1973/74, the current account showed a surplus for the first time after a decade, due to the developments in the oil sector. The surplus in overall balance of payments more than doubled that of the previous year. The foreign exchange receipts of the oil sector, which amounted to SDR 4.2 billion in 1973/74, are expected to rise to about SDR 17 billion in 1974/75. Non-oil export receipts, which had risen at an annual rate of 23 per cent in the five years ending in 1973/74, rose at an annual rate of 25 per cent in 1973/74 and are expected to keep the same pace in 1974/75. Import payments increased by 49 per cent in

1973/74 and are expected to rise by 67 per cent in 1974/75. The deficit in the service account is also rising from SDR 301 million in 1973/74 to SDR 660 million in 1974/75. Total official aid, loan, and credit commitments to the developed and developing countries are estimated to be in excess of $10 billion with disbursements to the end of March reaching $3.4 billion. Joint cooperation agreements have already been signed with 27 countries--rich and poor, East and West.

The net result of all these factors is an overall balance of payments surplus of SDR 6.6 billion in 1974/75, up from SDR 900 million in 1973/74. The surplus position in 1974/75 would have been much stronger had it not been for the vigorous balance of payments policies followed by the authorities, including a reduction in import taxation and quantitative import restrictions, freedom of access to foreign exchange, curtailment of new borrowing abroad, accelerated repayments of foreign debt, advance payments for imports, and heavy disbursements on loans and investments including aids.

The exchange rate for the Iranian rial which until February 12, 1975 was pegged to the U.S. dollar, is now linked to the International Monetary Fund's special drawing rights. The new decision is intended to isolate domestic import costs from speculative dollar flows in world money markets, and to ameliorate the effect of rising import prices on the domestic price level. To this end, the rial was upvalued by 1.5 per cent in terms of the U.S. dollar on February 20, 1975.

In short, the Iranian economy, which over the past years has achieved a remarkable rate of growth, gives every indication of continued planned expansion in the future. The Iranian authorities are fully aware and mindful of domestic physical bottlenecks and inflationary pressures. They are making every effort to increase available supplies and to expand productive capacity. In fulfilling their international obligations, the authorities have adopted economic policies fully consistent with the country's temporary surplus position and relative affluence. As circumstances permit, these policies will be followed in the months to come.

Mr. Amuzegar added that he deeply appreciated the very thorough and up-to-date staff paper on recent economic developments; indeed, it was the type of paper that should be produced for all developing countries.

Mr. Wahl, after noting his general agreement with the staff appraisal and the proposed decisions, commented that while oil had obviously been an essential ingrediant in the remarkable expansion of the Iranian economy during the previous year, another factor had been the determined and sensible policies pursued by the authorities. During the period of the revised Fifth Development Plan the Government had been able to continue to pursue its objectives of rapid growth and modernization of the economy, while ensuring that the less privileged were provided with the means and the incentives to move from traditional occupations to more productive fields.

The main challenges facing the economy were whether certain bottlenecks would impede development, and whether large increases in funds could be absorbed productively without leading to potentially serious inflation, Mr. Wahl continued. In fact, the adoption of appropriate fiscal, monetary and foreign exchange policies had played an important role in minimizing inflationary pressures, and in avoiding structural problems in the economy. He wondered whether the fiscal surplus would substantially exceed the Rls 300 billion predicted by the staff, or remain at that level as indicated by Mr. Amuzegar; further, in view of the widening gap between domestic food supply and demand, he doubted whether the efforts of the authorities to accelerate the rate of growth in agriculture--which continued to employ 40 per cent of the labor force and contributed about 12 per cent to real GDP--were sufficient. Finally, he congratulated the authorities for their contribution to the international adjustment process.

Mr. Harley, after commenting that the staff report was a succinct and straightforward account of the transformation in both the budget and balance of payments consequent upon the sharp increase in petroleum prices experienced since late 1973, noted that Mr. Amuzegar had mentioned a budget surplus of Rls 300 billion, equivalent to SDR 3.65 billion, in the fiscal year 1974/75, "after a decade of continuing fiscal deficits." The balance of payments surplus for the same period was estimated at SDR 6.6 billion, and both figures would have been much larger if the authorities had not taken specific measures to keep them down. Budgetary expenditures had been sharply increased, and the balance of payments surplus had been reduced by encouraging imports, removing import restrictions, accelerating repayment of foreign debt, and by granting very substantial foreign aid. Those measures represented a welcome contribution to international adjustment. The estimate given by Mr. Amuzegar for total official aid, loan, and credit commitments of more than $10 billion was impressive. Disbursements under those commitments, to the end of March 1975, were forecast to reach $3.4 billion, he observed.

With respect to the changes in the Fifth Development Plan, the priorities adopted by the authorities appeared fully appropriate, Mr. Harley continued. Although petroleum might be important in terms of the budget and balance of payments, non-oil sectors of the economy far cutweighed the oil sector in terms of GDP. The apportunities for development in industry and agriculture were substantial. The revised

Plan called for early concentration on petrochemical development and for substantial investment to overcome bottlenecks in the ports, the transportation system, the power sector, and the supply of construction materials. A further priority was development of the agricultural sector, for which he had particular enthusiasm. The Plan also stressed the attention that the authorities were giving to socioeconomic objectives designed to accelerate the rise in the standard of living of the population, so that the benefits of rising oil prices could be shared as widely as possible.

The staff papers and the authorities seemed to differ, Mr. Harley observed, regarding the speed with which Iran could efficiently absorb new investment. On page 1 of its report (SM/75/24) the staff had reported that the authorities had geared their economy and their economic and financial policies to a substantial absorption of the expanded oil revenues in a relatively short period of time, whereas on page 13 the staff said that "given the existing physical constraints, an increase in total demand beyond a certain level will cause severe pressures on domestic resources." Further, the staff remarked that government fiscal operations constituted the primary source of increased demand, and suggested that restraint of government expenditures would be wise. However, he believed that the authorities were fully aware of the physical bottlenecks in the economy, and that efforts were being made to increase available supplies and to expand productive capacity. Mr. Amuzegar had conceded that the rapid increase in domestic expenditures had contributed to the rise in domestic prices and had tended to inflate the cost of investment, but had added that his authorities believed that a certain amount of inflation was a fair and unavoidable price to pay for their ambitious development objectives. It seemed that both the staff and the authorities agreed that the present situation provided room for rapid development and permitted, and indeed demanded, a very sharp increase in imports to assist in that effort. If views differed, it was with respect to the speed with which the country could use its new wealth to maximum efficienty. Although the national authorities were clearly in the best position to judge their domestic requirements, he tended to agree with the staff that a somewhat greater degree of caution would best serve Iran's long-term objectives. He noted with interest that the Five-Year Plan would be incorporated into a Twenty-Year Plan.

Mr. Kharmawan, after commenting that Iran was using its increased resources to accelerate its development program, remarked that it had not started its economic development in 1974, but had had a broadly based development plan in existence for a number of years. To achieve higher rates of growth under conditions of relative price stability, the Government had taken steps to secure a larger flow of goods by liberalizing or lifting controls and restrictions on imports, and by introducing subsidies. Despite those measures, inflation had increased from approximately 6 per cent in 1972/73 to 14 per cent in 1973/74, and had continued to rise in the first half of 1974/75. Bottlenecks were one of the factors behind rising domestic prices. Because of the rise in inflation, the staff had cautioned the authorities against too rapid an expansion of the economy.

Among the bottlenecks identified by the staff were those of port and transportation facilities, and the shortage of skilled labor, Mr. Kharmawan continued. The physical shortages would, of course, limit the implementation of the development program, in the sense that the envisaged expenditures might not be fully used. But, did such a shortfall generate rising prices or simply a lower rate of growth than projected? A similar question could be asked regarding the shortage of skilled labor, although he realized that wages might tend to increase if demand became stronger. Iran had ample monetary resources that could be used to meet an increased demand for goods by enlarging its imports, which, in fact, was what the Government had done. However, the price of imported goods had increased substantially. He wondered whether increases in import prices should not be identified as one of the main factors behind inflation, rather than the bottlenecks that could only limit the programmed rates of growth. Although the budget was in surplus, the money supply should be carefully watched. The surplus might be even larger if projects could not be implemented within the time period of the budget. As Iran had such tremendous resources that could be used to match increased demand with increased supply, he doubted whether the conventional wisdom of caution applied.

Iran had embarked on a program of financial assistance to developed and developing countries that not only benefited itself, but also benefited others, Mr. Kharmawan commented. He expressed his gratitude for the assistance given to his own country.

Finally, Mr. Kharmawan noted that the authorities had decided to link their central rates to the special drawing right. He could endorse the proposed decision in the paper on the exchange system (SM/75/48), since it recognized that occasional nonobservance of the margins might occur.

Mr. Kawaguchi stated that the economy was facing new challenges and opportunities as a result of the vast increase in resources, and it would be interesting to watch how the country could achieve an accelerated rate of economic development through such a huge infusion of money and resources. At the same time, Iran recognized its new status and responsibility as a member of the international community, as indicated by both the staff and Mr. Amuzegar.

The broad policy framework of the authorities was appropriate, Mr. Kawaguchi believed. However, their major problem was the limitation on absorptive capacity, due in particular to the shortage of skilled labor, for which there would be no immediate solution. Thus, the flexible attitude of the authorities in the short run and the priority given to the Development Plan as a long-term target were quite appropriate. Given the existing bottlenecks, he understood the staff concern that too rapid a growth might result in rising domestic prices and an inflation of the cost of investment. However, as the authorities were willing to pay that price, he would support their judgment.

With specific reference to the revised Fifth Development Plan, Mr. Kawaguchi noted that the public sector would play an even more dominant role than in the past. It was inevitable that the Government would take the initiative in pursuing economic development, but it should make every effort to foster private sector entrepreneurship and dynamism, in order to secure self-generating growth over the long run. In pursuit of such growth, prompt and appropriate adaptation of policies to the rapidly changing economic structure was very important. For instance, the tax system needed to be adjusted to secure social equity. Both the authorities' intention to introduce a tax reform to broaden the tax base and the various measures taken to strengthen the banking system were pertinent.

Regarding external policies, Mr. Kawaguchi said that he appreciated the various measures taken by the authorities to eliminate restrictions and stimulate imports, and he welcomed the authorities' continued support for the Fund's oil facility. Finally, he would give his support to the proposed modification of the exchange system.

Mr. Pieske commented that Iran deserved to be commended, not only for its impressive growth rates, which had been high even before the oil price increases, but also for the responsible policies that the authorities had followed to facilitate balance of payments adjustment. The list of measures that had been taken to increase imports of goods and services and to export capital were impressive. Nevertheless, he would support the recommendation by the staff for a continued reduction of the degree of import protection. Such an action would be not only in the international interest, but also in Irans' own interest, as an increase in imports was an essential requirement for the realization of its vast development projects. Moreover, in the longer run, even the import competing industries would profit, since they would be encouraged to improve both their production methods and their competitive position. The staff mission, it appeared, had drawn the attention of the authorities to the "Declaration on Trade Measures"; as he had not seen similar statements in other recent consultation reports, he inquired whether the Fund kept urging members to subscribe.

The description of most of the elements in the economic picture had been comprehensive, Mr. Pieske indicated, but the information given in the staff report on reserve management policies was rather brief; he would have liked to have had more information on the policies followed by the authorities.

Like other speakers, Mr. Pieske expressed his appreication for Iran's lending to the Fund and its other measures to promote net capital exports. Measured against most recent balance of payments estimates, the commitment to lend a further $1 billion in 1975 represented a very significant contribution to the recycling of oil surpluses. He noted that Mr. Amuzegar's statement seemed to imply that Iran had found itself in a position of having to discourage speculative capital inflows, which was something that so far apparently only developed countries had experienced, and he therefore wondered whether his interpretation was correct.

Commenting on the domestic sector, Mr. Pieske believed that the emphasis that would be given to the attainment of socioeconomic development would make an important contribution to both economic and political stability and progress. The measures taken in the agricultural sector--land reform, rural cooperatives, and the creation of the Agricultural Joint Stock Companies--and the special emphasis that the sector was to receive in the Fifth Development Plan, were most welcome. In view of the prospects for world food supplies, it was certainly necessary to aim at increased production in all developing countries. In that context, he wondered whether Iran, with its large agricultural population, should be content to aim at less than self-sufficiency in food production. The figures contained on page 43 of the staff paper on recent economic developments (SM/75/37) did not indicate that much emphasis was to be given to agriculture, as the annual growth rate in that sector was expected to be 7 per cent, compared with 18 per cent in industry and mines, 16.4 per cent in services, and 51.5 per cent in the oil sector. The staff noted that the large-scale dam system irrigated relatively little land, due to a lack of completed distribution systems; however, further investment might well produce relatively large benefits.

As to the general stance of economic and development policies, Mr. Pieske said that he understood the desire to speed up the development process as much as possible and to utilize the resources available to the fullest extent. Although he did not wish to quarrel with the policy of accepting a certain degree of inflation as the price of accelerated development, he noted that there were physical constraints, such as a manpower shortage, which could not be easily circumvented. Present educational and training facilities seemed unlikely to be sufficient to provide for the 1.4 million new jobs that were expected to be filled under the Fifth Development Plan. Moreover, the risks of further accelerating price increases should be carefully weighed. Unlike Mr. Kharmawan, he believed that a large part of the price increases had been generated internally. The table on page 34 of the staff paper on recent economic developments clearly showed that prices for home produced goods had risen more quickly than those for imported goods. As it was less than fully convincing to hear a claim that the international environment was responsible for internal price developments, he would support the proposed recommendation to adjust expenditure plans in line with the absorptive capacity of the economy. Finally, he remarked that the authorities had behaved in an internationally responsible manner through their adjustment policies.

Mr. Bull, after noting that the authorities had reacted with impressive speed and skill to their new situation, remarked that his authorities welcomed the constructive external policies that Iran had pursued in the previous year.

If there was any uncertainty about the future, it was only whether the development effort was proceeding at too great a speed and whether strains would develop to the detriment of the economy, Mr. Bull continued. While he had sympathy with the need to develop at a fast rate, he doubted whether a slower expansion of the industrial sector would, as the authorities had argued, result in a higher rate of inflation later. However, the likely trends in the terms of trade and in domestic price levels would have to be known before a sound judgment could be reached. An assessment would also have to be made of the opportunity cost of delaying investment, on which the Government clearly placed a high value. The issue, therefore, could only be resolved by a political decision of the Iranian Government; hence, he hoped they had had sufficient expert advice from the World Bank and other development agencies.

The level of government expenditure would be tolerable only if the authorities were correct in their estimate of the private sector demand for imports, Mr. Bull considered. If the capacity of the private sector to import had been overestimated, and if the forecast 40 per cent rate of increase in domestic liquidity were exceeded, considerable pressures would develop on domestic resources, which might lead indirectly to a sharp increase in the cost of the Government's investment program. Since the authorities were already committed to their program, they should consider what courses remained open if it became evident that the expansionary effect had been underestimated and if pressures did become too serious. The remarkable progress in opening up import markets made him doubt whether more could be done to stimulate imports directly. Moreover, while the decision to modify the exchange rate was wise, he would not urge the authorities to pursue greater exchange rate flexibility. As port capacity was severely limited, the Government could do little on the external side to assist demand management. Therefore, the only means of countering the tendency to overheat seemed to be through reduced private sector credit. But the staff was probably correct in saying that the present policy regarding the private sector was broadly appropriate. It would be unwise to upset the balance between private and public sector investment. Therefore, if some adjustment in the price of development were needed, it could best be made by not taking up any slack in government expenditure that might emerge, rather than by any downward revision of plans.

Commenting specifically on the development plan, Mr. Bull shared the view expressed by Mr. Pieske on the lack of concentration on agricultural development, and also on the priorities accorded to education. Indeed, education seemed to be one of the most fundamental bottlenecks, at least with regard to the lack of skilled manpower.

Finally, Mr. Bull commented that it was unfortunate that Iran was not yet able or willing to accept the obligations of Article VIII. In addition, he hoped that the authorities would give further consideration to the possibility of making the rial fully usable in the Fund. Since the Articles of the Fund said that members should operate within a multilateral system of payments, the authorities should reconsider their movement toward bilateral payments agreements.

Mr. Lieftinck remarked that the enormous oil resources, together with the price increases, gave Iran a good opportunity to speed up its development effort. The authorities had made impressive adjustments to the Fifth Development Plan. However, he had the feeling that agriculture had not been given an appropriate share. Although expansion in the agricultural sector was unavoidably a slow process, specific measures could be taken that would mature in the not too distant future.

Many policies needed to be reconciled with others, Mr. Lieftinck continued. For instance, the authorities would have to reconcile the objective of accelerated development with the requirement for a tolerable level of inflation. He agreed with the language in the proposed decision to the effect "that the authorities should keep in view the need to adjust their expenditure plans in line with the absorptive capacity of the economy," rather than fall short of projected budget expenditures. Additionally, the authorities had subsidized imported basic foodstuffs in order to reduce the impact of high agricultural prices on the cost of living. While he understood the rationale for such a scheme, he felt it was likely to weaken the incentive to domestic agriculture, as low food prices would have an adverse impact on expansion. A further instance in which reconciliation was difficult was the authorities' tax relief on imports, which was undoubtedly the correct policy, as Iran should have a very low tariff on imports and should maintain tariffs only for unavoidable protective purposes. However, other tax measures had been implemented that gave greater relief to public employees than private employees. Because such a policy made the public sector more competitive, and the authorities were in great need of able civil servants, he understood why the tax relief had been introduced, although it somewhat militated against the principle of equal taxation for equal incomes. The whole trend was toward tax reduction and tax relief, which made the budget even more dependent on oil revenues than otherwise would be the case, and which might also have some adverse effect with respect to after-tax income distribution. As the authorities would have to harmonize their efforts to keep the cost of living down and give additional stimulus to economic development, he welcomed the announcement that a tax reform was under consideration.

The reduction of the import deposit requirement to a flat 15 per cent could release a large amount of deposits and cause liquidity in the economy to increase, Mr. Lieftinck observed. While he hoped that the import deposit requirement would be completely abolished--as it dated to a previous period when there had been a need for it--he realized that the authorities were also trying to bring total liquidity under control. With respect to the interest rate structure, again the authorities had a difficult problem of reconciliation. Interest rates had risen as a result both of the high demand for credit and of the constraints applied by the monetary authorities on credit expansion, and they might provoke an inflow of capital. In fact, the authorities were considering whether they should introduce restrictions to prevent such an inflow. Overall, he had the impression that the authorities were well aware of their difficulties and would find the appropriate answers.

As to the external sector, Mr. Lieftinck noted that in 1974/75 oil earnings were expected to be SDR 17 billion, and might exceed SDR 20 billion in 1975/76. As the overall balance of payments surplus was estimated at SDR 6.6 billion for 1974/75 and SDR 3.4 billion for 1975/76, he was greatly impressed by the large contribution by Iran to the adjustment process--the authorities had allowed large imports and promoted large capital outflows. If they had not done so, the flow of oil earnings would have constituted a very serious problem for the rest of the world. The authorities had acted responsibly in reducing the adjustment problem for others, particularly the less developed countries, and their contribution to the oil facility was most valuable.

With respect to the exchange rate system, Mr. Lieftinck wondered why the authorities had introduced a dual market system, as the rates showed practically no differential, and policies were aimed at keeping them as close together as possible. Finally, he hoped that Iran would be able to accept the obligations of Article VIII, and make the rial more usable in the Fund.

Mr. Cole noted that the Iranian economy had continued to expand at an enviable rate during the previous year, and that expansion had covered most sectors of the economy. Moreover, he was impressed by the policies pursued by the authorities, and in particular those of development and reserve management. Further, the country's resources had been utilized both wisely and constructively. Current and investment expenditures had been increased quite significantly, to improve the standard of living of the population and further raise the rate of growth of the economy. However, the shortage of skilled manpower, the limitations on port capacity, and on the transportation system would probably restrict the rate of growth. He welcomed, therefore, the intention of the authorities to devote large investment expenditures to the sectors in which there were bottlenecks.

Strong inflationary tendencies were likely to be aggravated by further demand pressures, labor shortages, and other bottlenecks, Mr. Cole continued. Appropriate adjustments in monetary and fiscal policies would be required to moderate wage demands, and to match the rate of growth of money supply with the absorptive capacity of the economy, In that connection, he noted that measures were being taken to overcome the labor constraints through the use of foreign labor, better utilization of existing manpower resources, and expansion of labor training programs. In addition, the authorities were watching developments in the structure of interest rates with a view to acting when the need became apparent.

The liberal trade and payments policies pursued by the authorities were highly desirable, Mr. Cole considered, not only from the point of view of Iran, but also from that of the international community. Finally, he congratulated Iran for adopting sound reserve management and investment policies, and for its generous contribution to various recycling mechanisms as a means toward facilitating the adjustment process, and for providing temporary relief to oil importing countries.

Mr. Tilakaratna remarked that the fiscal and external policies of the authorities were geared toward absorbing the increased oil revenues in a short time. Indeed, the basic objective of the revised Fifth Development Plan was to achieve a rapid rate of economic growth and to accelerate the rise in the standard of living of the Iranian people. Although subsidization of foodstuffs should lead to a better distribution of income, he agreed with Mr. Lieftinck that subsidies could result in a disincentive to domestic production. Moreover, since the Government's net domestic fiscal operations constituted the primary source of increased demand in the economy, the level of government expenditures had to be carefully watched. At present, the substantial increase in oil revenues provided an adequate cushion for absorbing higher social and economic development expenditures. Nonetheless, the domestic price situation had to be kept under close review.

The recent monetary measures adopted by the Bank Markazi should help to achieve reasonable monetary stability, Mr. Tilakaratna observed, and at the same time, induce the private sector to invest. In addition, he would support the proposed decision on the modification of the exchange system, as the change would facilitate the achievement of the targets of the authorities.

The Government was correct to aim at substantial social and economic infrastructure development in the medium term, Mr. Tilakaratna believed.

While it had attempted to diversify the economy through a program of rapid economic development, several bottlenecks still existed; the quicker those bottlenecks were overcome the quicker it would be possible to launch a development program of a self-sustaining character. During the initial phase, a cushion for absorbing the large infrastructure expenditures existed; thereafter, the process of economic development should become self sustaining. Diversifying the economy would be necessary for Iran because of its large dependence on a single, exhaustible resource.

Regarding the external sector, Mr. Tilakaratna commented that Iran was behaving as a responsible member of the international community. As part of their adjustment policy the authorities had initiated a large program of external loans and investments. In fact, Iran's commitments and disbursements of aid to less developed countries constituted substantially more than 1 per cent of GNP, for which the authorities were to be commended. Finally, he thanked them for the generous assistance they had given to his constituents.

Mr. Albuquerque noted that although the economy suffered from some bottlenecks and continued inflation, Iran had behaved as a highly responsible member of the international community, particularly with regard to the adjustment process. Finally, he would support both proposed decisions.

Mr. Brand observed that while the first line of the staff appraisal referred to "rapid broad-based growth," page 21 of the staff paper on recent economic developments (SM/75/37) said that "the agricultural sector, which employs about 40 per cent of the labor force...has been declining for some time... . This downward movement resulted from a relatively slow rate of growth in agricultural output." He would therefore welcome further background information, and he wondered whether the staff still felt that growth had been broad-based. Although the table on page 121 of the staff paper on recent economic developments seemed to show that the increase in imports had been broad based, he doubted whether the table was complete. In that table, imports for 1973/74 were given as SDR 3.1 billion, whereas in the balance of payments table on page 119, imports were shown as SDR 3.6 billion.

Commenting on the exchange system in relation to the guidelines on floating, Mr. Brand wondered whether Iran could be regarded as a Category 3 country--a member that, though its currency was pegged to another currency, changed the peg frequently in the light of some formula relating, for example, to price indices--or as a Category 4 country--a member whose currency was pegged to a composite of other currencies? It seemed to him that the rial was pegged narrowly to the U.S. dollar and widely to the SDR, and it might be that its pegging to the U.S. dollar in normal circumstances would be more significant than its wide pegging to the SDR. Finally, he inquired why--in its appraisal on the exchange system--the staff said that "Iranian imports originate primarily from European countries and Japan," whereas in fact, the U.S. share was also quite considerable.

The Chairman, in response to Mr. Pieske's question about the "Declaration on Trade Measures," said that the matter was raised in each country that had not yet decided whether or not to sign the declaration.

The Acting Director of the Middle Eastern Department commented that Executive Directors had focused on two broad issues. First, regarding various aspects of inflation, Mr. Kharmawan had inquired about the relevant factors in assessing inflation, and other Executive Directors had remarked on the relationship between the level of government expenditures and price increases. The staff mission and the authorities agreed that both the higher cost of imports and the existence of some bottlenecks had contributed to inflation. He agreed with those speakers who believed that the level at which the costs in terms of inflation from rising government expenditures became intolerable was a political decision; the staff had pointed out the relevant factors, of which the authorities were already well aware.

Second, concerning agriculture, the authorities believed that the emphasis that was being given was quite proper, the Acting Director continued; it had increased in recent years and there had probably been an underemphasis on agriculture in earlier development programs. However, the problems of achieving an adequate growth rate were quite considerable; for instance, heavy capital investment was involved, which might be quite slow-yielding in terms of increased output. Moreover, difficult structural and social problems existed. While the efforts to deal with those problems had increased enormously, it was still true that growth in the agricultural sector lagged behind that of other sectors. But those other sectors started from a very small base and higher growth rates were therefore easier to attain. Additionally, it was realistic to expect that Iran would continue to import large quantities of foodstuffs. In working out a proper allocation of resources--taking into account the comparative advantage of various sectors--it was likely that Iran might not become self-sufficient in food production. Moreover, the proper use of resources might dictate that self-sufficiency was not an appropriate economic objective.

In response to Mr. Wahl's question about the size of the fiscal surplus, the Acting Director remarked that the quite recent figure quoted by Mr. Amuzegar was likely to be more accurate than the staff's earlier estimate based on discussions that had taken place in November and December 1974.

Concerning Mr. Lieftinck's query why Iran had a dual exchange market, the Acting Director recalled that in the past the authorities had enforced a few restrictions on current payments, and capital transactions could only be carried out through the official market to a limited extent. At the same time a parallel market had been tolerated in which those transactions not permitted in the official market had taken place relatively freely. The exchange rate in the parallel market had deviated to a small extent from the official market. As the Iranian foreign exchange position had improved, the authorities had felt that they should gradually eliminate the restrictions on current payments. However, there had been a reluctance to allow all transactions freely in the official market. Therefore, the authorities had established a second market, which had permitted capital transactions to take place through a legally recognized market rather than through a parallel market; in practice, the two had become merged.

The divergence in import figures referred to by Mr. Brand, the Acting Director explained, was due to one table being based on customs data, which usually provided a breakdown by commodity or area, while the other was derived from the balance of payments data.

The staff representative from the Exchange and Trade Relations Department, in reply to Mr. Brand's question about the appropriate classification of the Iranian currency, said that, as the rial was now pegged to a basket of currencies, although rather loosely in order to avoid making frequent changes in the rial-U.S. dollar rate, Iran should be considered as a Category 4 country.

Mr. Amuzegar commented that the problem of bottlenecks and the pressures of inflation emphasized by many Executive Directors were known to his authorities, and that they were doing everything they could; for instance, some supplies had been airlifted, and 3,000 truck drivers had been recruited from Pakistan to move goods from the ports.

The revision of the tax system was important, Mr. Amuzegar continued, because the authorities would make sure that taxes would be levied with a view to the future when oil would no longer give all the benefits that it did at present.

Regarding Mr. Pieske's remarks on the desirability of reducing import restrictions, Mr. Amuzegar indicated that they had been reduced, and that the remaining restrictions were maintained purely for protective purposes and not for revenue raising. In fact, the value of imports was expected to be about $10 billion in 1974/75, to rise to $14 billion in 1975/76, and to reach $40 billion in 1982. Such figures could not be achieved without removing restrictions, except for those that were absolutely essential.

As to Mr. Pieske's inquiry about speculative capital inflows, Mr. Amuzegar remarked that although Iran had not experienced such inflows, his authorities were worried and were trying to take some measures to prevent them. The reduction in the rate of interest recently announced by the Central Bank--interest rates were moving downward all over the world--was designed to prevent such inflows.

Commenting on Mr. Bull's worry about reduced credit to the private sector, Mr. Amuzegar said that the decisions taken by the Central Bank were designed to help the private sector accomplish what the planners thought it ought to contribute toward the Fifth Development Plan.

Bilateral payments agreements with several countries--one Fund member and some non-Fund members--had been a concern of the Executive Board and many Executive Directors for years, Mr. Amuzegar recalled. However, it was the desire of his authorities to have bilateral agreements with certain countries, as the system in some of those countries did not allow them to do otherwise.

Dealing with Mr. Lieftinck's concern that agriculture had not yet been given an appropriate share of investment, Mr. Amuzegar commented that, given the socioeconomic circumstances and the difficulties involved in increasing agricultural production, his authorities considered that the emphasis they had given was appropriate; of course, that was a matter for judgment. Agriculture was the most difficult sector of any economy to develop; certainly, in general it was much easier to increase growth faster in other sectors of the economy than in agriculture. Moreover, the agricultural sector had experienced a very severe problem of transition from a feudal system to a free system, with a large number of farmers being liberated and becoming entrepreneurs without having adequate business knowledge. However, the greatest obstacle to Iran's agricultural development was the scarcity of water. Despite many erudite treatises, the country was not agricultural and could never really become so, especially if the population continued to increase at the same rate as it had in the past. Many planners believed that the country would have to rely on imported food for some time, simply because of the lack of water. Therefore, it was not really a question of a lack of will, or deficiencies in policies, or even the lack of diligence on the part of the farmers, but the lack of water. In fact, the staff had referred to a relative decline in the share of GDP of agriculture--not an absolute decline--because of a tremendous increase in the share of other sectors. It was obvious that agriculture had not grown as fast as other sectors, but the reasons were known and were not unique to Iran.

The subsidies that had been given to food imports and the possible weakening effect on incentives to produce food had been mentioned by two Executive Directors, Mr. Amuzegar observed. However, those measures were never considered to be permanent, but transitional to deal with a particular situation. In fact, they had reached their peak in 1974 when food import prices were highest. Now that there had been some slackening of demand and some reduction of prices for food imports, he expected that the subsidies would gradually be diminished. In addition, the Government was taking constructive measures, such as new guaranteed minimum prices for a number of commodities, as an incentive to increase agricultural production.

Concerning the dual market exchange system, Mr. Amuzegar noted that the idea originally had been that the nonofficial free market could serve as a shock absorber for speculative inflows of capital. In fact, such inflows had not occurred, and for all practical purposes two markets did not now exist.

Finally, Mr. Amuzegar agreed with Mr. Brand that the exclusion of the United States from the list of Iran's major sources of imports was perplexing. A substantial part of the country's imports originated from Europe, Japan and the United States, and 80 per cent of transactions were denominated in U.S. dollars. Indeed, his authorities had signed a $15 billion bilateral payments agreement with the United States, which involved importing goods to the value of $3 billion per annum for the next five years.

The Executive Directors then turned to the proposed decision on the modification of the exchange system.

Mr. Pieske doubted whether it was correct to refer to "parity in terms of the special drawing right"; the wording "parity as expressed in terms of special drawing right," was better. Generally, the determination of parities in terms of gold had become obsolete. While considering the amendments to the Articles, the Executive Directors should examine the present parity provisions.

The Deputy General Counsel believed that more suitable wording would be "on the basis of Rls 82.2425 for one special drawing right." In addition, the phrase "of 2.25 per cent on the special drawing right" should be inserted after "wider margins" in the second sentence of paragraph 1 of the proposed decision. As to the basic question of parities, in the present circumstances it was difficult to say whether a member was maintaining a parity in the sense of the Articles of Agreement. If there was a way in which a member could maintain a par value, it would be by maintaining rates on the basis of the SDR, in terms of the gold/SDR relationship, as Iran was trying to do. However, many operational and technical difficulties existed in maintaining rates within limits on the basis of the SDR and therefore the gold equivalent.

The Executive Directors accepted the Deputy General Counsel's proposed changes.

Mr. Bull commented that the omission of the word "parity" from the decision was unfortunate.

Mr. Kharmawan asked whether "occasional brief nonobservance of the margins" would apply to all countries in a situation similar to that of Iran.

The Chairman replied that each case would be examined on its own merits, but in general it would be reasonable for members not to observe the margins if the situation were the same as that of Iran.

The Executive Directors approved the proposed decision.

The decision was:

1. With effect from February 12, 1975, Iran advised the Fund that it ceased to peg the Iranian rial to the U.S. dollar and will maintain the exchange rates for the Iranian rial on the basis of Rls 82.2425 for one special drawing right. Iran will continue to avail itself of wider margins of 2.25 per cent on the special drawing right. In order to avoid making frequent changes in the rial/dollar rate, occasional brief nonobservance of the margins might occur.

2. The Fund notes the intention of the Iranian authorities to maintain the exchange rate of the rial in terms of the value of the special drawing right as defined by Rule O-3 and to continue to avail themselves of wider margins.

Decision No. 4610-(75/29), adopted
March 12, 1975

The Executive Directors then turned to the proposed decision on the 1974 Article XIV consultation with Iran.

Mr. Amuzegar suggested that the fourth sentence of the third paragraph should read "the Fund notes that the authorities intend to keep in view the need to adjust their expenditure plans in line with the absorptive capacity of the economy," and that the fourth line of the fourth paragraph should read "...large program of foreign aid, loans and investments."

The Executive Directors approved the proposed decision, as amended.

The decision was:

1. This decision is taken by the Executive Directors in concluding the 1974 consultation with Iran pursuant to Article XIV, Section 4, of the Articles of Agreement.

2. The Iranian economy, stimulated by expanding government expenditures and vigorous activity in the private sector, has been experiencing rapid broad-based growth. Price increases, however, accelerated in 1973/74 partly reflecting external factors. The balance of payments recorded substantial and rising surpluses mainly as a consequence of the sharp increase in oil receipts.

3. The Iranian authorities are planning to accelerate the development of the economy. Toward this end, they have made substantial adjustments in their balance of payments policies and have taken steps to ease supply constraints. Despite these measures, the projected large increase in the Government's net domestic expenditures might lead to intensification of pressures on domestic resources. The Fund notes that the authorities intend to keep in view the need to adjust their expenditure plans in line with the absorptive capacity of the economy.

4. Iran's strong balance of payments position has permitted the effective elimination of all exchange restrictions, considerable reduction in import cost and quantitative restrictions, and the initiation of a large program of foreign aid, loans, and investments. These measures are expected to achieve a considerable reduction in Iran's overall external payments surplus in 1975/76. The Fund believes that these policies are appropriate in the present circumstances. The Fund hopes that Iran will take steps to terminate its bilateral payments agreement with a Fund member and will continue its policy of reducing the degree of import protection.

Decision No. 4611-(75/29), adopted
March 12, 1975

4. YEMEN ARAB REPUBLIC - 1974 ARTICLE XIV CONSULTATION

The Executive Directors considered the staff report and proposed decision for the 1974 Article XIV consultation with the Yemen Arab Republic (SM/75/19, 1/21/75; and Cor. 1, 3/7/75). They also had before them a report on recent economic developments in the Yemen Arab Republic (SM/75/20, 1/28/75; and Cor. 1, 3/7/75).

Mr. Deif made the following statement:

On behalf of the authorities of the Yemen Arab Republic and myself, I thank the staff for the reports it prepared on the 1974 Article XIV consultation (SM/75/19 and Correction 1; SM/75/20 and Correction 1). They are typically sobering in the information they contain, revealing in the analysis they provide, and realistic in the advice that they extend.

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

IMMEDIATE ATTENTION

Mr. John Gunter

Room 3-314-C
#1

SM/75/24
Supplement 1

CONTAINS CONFIDENTIAL
INFORMATION

March 12, 1975

To: Members of the Executive Board

From: The Acting Secretary

Subject: Iran - 1974 Article XIV Consultation

Attached is the Acting Secretary's record of the decision taken by the Executive Board at Meeting 75/29, March 12, 1975, on the 1974 Article XIV consultation with Iran. This text will be transmitted to the member after the close of business on Friday, March 14, 1975.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Iran - 1974 Article XIV Consultation

Executive Board Decision - March 12, 1975

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3. The Iranian authorities are planning to accelerate the development of the economy. Toward this end, they have made substantial adjustments in their balance of payments policies and have taken steps to ease supply constraints. Despite these measures, the projected large increase in the Government's net domestic expenditures might lead to intensification of pressures on domestic resources. The Fund notes that the authorities intend to keep in view the need to adjust their expenditure plans in line with the absorptive capacity of the economy.

4. Iran's strong balance of payments position has permitted the effective elimination of all exchange restrictions, considerable reduction in import cost and quantitative restrictions, and the initiation of a large program of foreign aid, loans, and investments. These measures are expected to achieve a considerable reduction in Iran's overall external payments surplus in 1975/76. The Fund believes that these policies are appropriate in the present circumstances. The Fund hopes that Iran will take steps to terminate its bilateral payments agreement with a Fund member and will continue its policy of reducing the degree of import protection.

March 11, 1975 - 75/25

Statement by Mr. Amuzegar on Iran
Executive Board Meeting 75/29
March 12, 1975

The Iranian economy continued to grow at an enviable pace during 1973/74. Real gross domestic product increased by 13.5 per cent, up from 12.9 per cent during the previous year. Consumption increased by 11 per cent, while gross domestic capital formation grew by more than 18 per cent. The output expansion covered most sectors of the economy. The oil sector's real value-added increased by 15.6 per cent; industrial and service sectors grew at rates of 18.9 per cent and 14.6 per cent, respectively; value-added in agriculture rose by an estimated rate of 5.8 per cent, as compared to a 3.4 per cent average annual growth rate during the Fourth Plan (1968/69 - 1972/73).

The petroleum sector continues to play a predominant role in the Iranian economy. In 1973/74 it provided 64 per cent of total government revenues and 81 per cent of foreign exchange receipts. These shares are expected to increase to 87 per cent and 93 per cent, respectively, in 1974/75 due to increases in both production and oil prices. Iran is also making increasing use of its vast natural gas resources (estimated to be about 13 per cent of the world total proven reserves) both for domestic and export purposes. In 1973, the foreign exchange receipts from this source of energy were about SDR 70 million, and have more than doubled during the first half of 1974.

In the light of 1973/75 developments in oil prices Iran's Fifth Development Plan (1973/74 - 1977/78) has been totally revised. The size of the Plan has more than doubled, from the original $32 billion to nearly $70 billion. The revision is made possible--indeed necessary--by the dramatic new changes in Iran's future financial position and exchange earnings. The oil price changes and related developments had made planned outlays and resulting economic growth estimates virtually obsolete even before the current Plan got firmly under way. The original growth target of 11.4 per cent a year at constant (1972) prices is now expected to reach 26 per cent. Even disallowing the influence of terms-of-trade in the oil sector on the GNP growth, the implied real rate of GDP during the plan period will in the staff's calculation be no less than 14 per cent a year, on the average.

Growth in Real resources availability

In the new draft, four basic considerations have been of paramount significance to the planners. First, financial and foreign exchange constraints which previously limited the size of the Iranian plans have been of minor significance. The planners have been able to aim at maximizing attainable growth targets. Second, since hitching the Plan's wagon virtually to a star has created new and different constraints, the planners' attention has focused on such production bottlenecks as inadequate skilled, technical, and professional manpower; insufficient infrastructures (e.g., ports, roads, and RR); and shortages of natural resources, raw materials, minerals, and other inputs. Third, due care has been taken to closely coordinate the process of five-year planning with the annual budgetary exercise--a procedure which could not always be meticulously observed before. Finally the new Plan has been carefully tailored to present the first phase of a long-term twenty-year socio-economic perspective.

The striking significance of the Fifth Plan's quantitative objectives and targets, however, cannot be truly appreciated without regard to the Plan's qualitative socio-economic considerations. Thus it should be noted that in order to accelerate the rise in the standard of living of the people and to share the benefits of rising oil incomes with all socio-economic strata, certain broad new social programs have been devised and are being introduced by the government. These measures include free primary education, a nation-wide preventive health program, increased subsidies for basic foodstuffs, and a higher minimum income for workers.

The high level of domestic expenditures has inevitably increased domestic prices and inflated the cost of investment. But the authorities believe these to be a fair and unavoidable price to pay for their ambitious development objectives. The implementation of these socio-economic programs, to be financed by increased revenues in the oil sector, has also naturally affected the government's finances and public expenditures. Nevertheless, thanks to rising oil revenues, not only has there been a reduction in net financing from the banking system, but there has also been a reversal from considerable net external borrowing to a small net repayment in 1973/74. In the current fiscal year (1974/75), the further increase in the oil revenues has dramatically changed the fiscal picture, causing an increase of over 150 per cent in current expenditures and capital investment over the figures for 1973/74. Consequently, the overall budgetary position is expected to be in surplus for some Rls. 300 billion after a decade of continuous fiscal deficits.

As efforts are made to alleviate the pressure on domestic resources through liberalized import policies, the sharp rise in import prices and payments has contributed to the growth of expenditures, and has been reflected in higher subsidies for basic foodstuffs. In the fiscal year 1975/76, due to the expected slowdown in expansion of oil revenues, and an estimated 30 per cent increase in current and fixed capital expenditures, the surplus is anticipated to be much smaller than in 1974/75. A broad-based tax reform to support the continued expansion of government financial operations in the future is under study.

In the monetary and credit area, the emphasis in 1973/74 continued to be on better liquidity management. Domestic liquidity expanded at the rate of 29 per cent last year, down from 35 per cent in 1972/73, as a result of appropriate measures taken by the Central Bank. These measures included an increase in the rediscount rates, an upward shift in the structure of interest rates on time and savings deposits, imposition of credit ceilings on commercial bank lending, a progressive raising of the required legal reserves on demand deposits (to 30 per cent by February, 1974), and introduction of marginal government bond purchase requirements on time and savings deposits.

The Bank Markazi's anti-inflationary programs which raised domestic interest rates by an average of 1.5 per cent on bank lending and imposed quantitative credit ceilings for commercial banks succeeded in keeping price inflation in check. In a recent move to give private investments a boost through lower interest rates, and to bring domestic rates more in line with international money rates the Bank Markazi, late in January 1975, authorized an expansion of credit, and reduced interest rates for private industry, commerce, agriculture, and construction. The Bank Markazi's own rediscount rate was reduced from 9 to 8 per cent, and allowed a reduction of lending rates by specialized banks by 2 per cent, and for deposit money banks by one per cent. The ceiling on banking system credit to the private sector was increased and legal reserve requirements were reduced. The new measures are designed to encourage private investment to meet the Fifth Plan's targets and to discourage speculative capital inflows following the downward movement in international money rates.

Prices which had increased at the moderate rate of 6 per cent in 1972/73, accelerated to an average annual rate of 13 per cent last year, partly due to the increased import costs. Price pressures have continued during the first half of 1974/75. In order to reduce the impact of higher import prices domestically, price control measures and price stabilization programs, which had been initiated before, were supplemented by price subsidies for basic foodstuffs. Steps were also taken to expand the flow of imports at lower costs through the provision of increased credit for imports, and a reduction of the import deposit requirements, import registration fee, and commercial benefit taxes for certain products. Rising prices, however, continue to be a major concern of the monetary authorities.

In the balance of payments for 1973/74, the current account showed a surplus for the first time after a decade, due to the developments in the oil sector. The surplus in overall balance of payments more than doubled that of the previous year. The foreign exchange receipts of the oil sector which amounted to SDR 4.2 billion in 1973/74, are expected to rise to about SDR 17 billion in 1974/75. Non-oil export receipts which had risen at an annual rate of 23 per cent in the five years ending in 1973/74 rose at an annual rate of 25 per cent in 1973/74, and are expected to keep the same pace in 1974/75. Import payments increased by 49 per cent in 1973/74 and are expected to rise by 67 per cent in 1974/75. The deficit in the service account is also rising from SDR 301 million in 1973/74 to SDR 660 million in 1974/75. Total official aid, loan, and credit commitments to the developed and developing countries are estimated to be in excess of $10 billion with disbursements to the end of March reaching $3.4 billion. Joint cooperation agreements have already been signed with 27 countries--rich and poor, East and West.

The net result of all these factors is an overall balance of payments surplus of SDR 6.6 billion in 1974/75, up from SDR .9 billion in 1973/74. The surplus position in 1974/75 would have been much stronger had it not been for the vigorous balance of payments policies followed by the authorities including a reduction in import taxation and quantitative import restrictions, freedom of access to foreign exchange, curtailment of new borrowing abroad, accelerated repayments of foreign debt, advance payments for imports, and heavy disbursements on loans and investments including aids.

The exchange rate for the Iranian rial which until February 12, 1975 was pegged to the U.S. dollar, is now linked to the International Monetary Fund's Special Drawing Rights. The new decision is intended to isolate domestic import costs from speculative dollar flows in world money markets, and to ameliorate the effect of rising import prices on the domestic price level. To this end, the rial was upvalued by 1.5 per cent in terms of the U.S. dollar on February 20, 1975.

In short, the Iranian economy which over the past years has achieved a remarkable rate of growth gives every indication of continued planned expansion in the future. The Iranian authorities are fully aware and mindful of domestic physical bottlenecks and inflationary pressures. They are making every effort to increase available supplies and to expand productive capacity. In fulfilling their international obligations, the authorities have adopted economic policies fully consistent with the country's temporary surplus position and relative affluence. As circumstances will permit these policies will be followed in the months to come.

March 10, 1975

MEMORANDUM FOR THE FILES

From: John W. Gunter

Subject: Proposed Changes in Consultation Decision on Iran

Mr. Amuzegar has informed me that he is planning to propose two amendments to the Proposed Decision relating to consultations with Iran; as follows:

1. In the last sentence, paragraph 3 would be changed to read as follows:

> "3. ... The Fund ~~believes~~ notes that the authorities ~~should~~ intend to keep in view the need to adjust their expenditure plans in line with the absorptive capacity of the economy."

2. The first sentence of paragraph 4 would be altered to read as follows:

> "4. Iran's strong balance of payments position has permitted the effective elimination of all exchange restrictions, considerable reduction in import cost and quantitative restrictions, and the initiation of a large ~~public-external~~ program of foreign aid, loans and investments. ..."

I informed him that I thought these changes would be acceptable to the staff.

cc: Mr. Mookerjee
Mrs. Lachman
Mr. Hitti

FOR AGENDA

SM/75/24

CONTAINS CONFIDENTIAL
INFORMATION

January 29, 1975

To: Members of the Executive Board

From: The Secretary

Subject: Iran - Staff Report and Proposed Decision for the 1974 Article XIV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1974 Article XIV consultation with Iran, together with the staff's analysis and recommendation. The decision proposed by the staff appears on pages 14 and 15.

This subject will be brought to the agenda for discussion on a date to be announced.

Att: (1)

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INTERNATIONAL MONETARY FUND

IRAN

Staff Report on the 1974 Article XIV Consultation

Prepared by the Staff Representatives for the
1974 Article XIV Consultation with Iran

(Reviewed by the Committee on Article XIV Consultations)

Approved by John W. Gunter and Subimal Mookerjee

January 28, 1975

I. Introduction

In accordance with established procedures, the 1974 Article XIV consultation discussions with Iran were held in Tehran during the period November 16-23, 1974. The Iranian representatives were led by His Excellency M. Yeganeh, Governor of Bank Markazi Iran (the Central Bank), and included senior officials of Bank Markazi, the Ministry of Economic Affairs and Finance, the Ministry of Commerce, the Plan and Budget Organization and other government departments and agencies. The mission also had discussions with His Excellency J. Amouzegar, the Minister of Interior. The staff representatives were Messrs. John W. Gunter, S.H. Hitti and H. Jakubiak (MED), R.H. Floyd (FAD) and Y. Iura (ETR). Mr. J. Amuzegar, Executive Director for Iran, attended some of the discussions.

The Iranian economy continued to grow at a very rapid pace in 1973/74 (Iranian year ended March 20) and the first half of 1974/75; the expansion was broad-based, encompassing most sectors of the economy. While price increases accelerated, partly reflecting external factors, the balance of payments position strengthened considerably. The net foreign exchange receipts of the oil sector nearly doubled in 1973/74 as a result of a rise in oil production as well as the price increases which were announced in October 1973. The full impact of the sharp rises in posted prices, which came into effect at the beginning of 1974, as well as other improved terms is reflected in an estimated quadrupling of oil receipts in 1974/75 to a level of about SDR 17 billion.

Recent economic and financial policies of the Iranian authorities have been geared, directly or indirectly, to a substantial absorption of the expanded oil revenues in a relatively short period of time. A high rate of expansion in the economy is being stimulated mainly through sharply rising government current and investment expenditures. With respect to balance of payments policies, the authorities have effectively eliminated all the restrictions on access to foreign exchange, instituted measures which decreased the landed cost of imports, and reduced quantitative restrictions on imports. The Iranian authorities have also sharply curtailed borrowing abroad, accelerated repayments on the external debt, and made substantial commitments for foreign loans and investments and advance payments for some imports.

The effectiveness of these policies is unavoidably limited by the existence of certain bottlenecks, mainly the shortage of skilled labor and limitations in port capacity and in the inland transport system. Despite these constraints, the overall balance of payments surplus is expected to decrease from approximately SDR 6 billion in 1974/75 to approximately SDR 3.5 billion in 1975/76. The discussions centered on the assessment of the impact of these policies and on Iran's contribution to the balance of payments adjustment process.

II. Report on the Discussions

1. Petroleum production and policies

Iran is the second largest oil exporter in the world. While substantial oil reserves are known to exist, the reserves to output ratio, assuming the present rate of production, is estimated at about 30. Consequently, the Government of Iran looks upon oil as an exhaustible national asset. Low prices tend to result in wasteful consumption of petroleum products and early exhaustion of the reserves. Therefore, in order to conserve petroleum and to encourage investment in alternate sources of energy, the Iranian authorities believe that the price of oil should not be less than the cost of alternate sources of energy. Currently, the Iranian representatives stated, the estimated per barrel price of petroleum extracted from oil shale and tar sands or the cost of the energy equivalent extracted from coal and nuclear power is markedly higher than prices for crude petroleum. Furthermore, the steep and continuing increases in import prices have prompted the Iranian authorities to call for indexing the price of oil in relation to the market prices of a basket of commodities imported by the oil exporting countries. They have also indicated a preference for replacing the system based on posted prices, which has become increasingly complex and unwieldy, by a unitary market price system (f.o.b.) for crude petroleum with variations for qualities of crudes. Decisions on these matters are being advocated within the context of OPEC.

With respect to production levels, the Iranian representatives stated that Iran is willing to reduce production as the country's foreign exchange requirements could be met by producing approximately 4 million barrels per day of crude petroleum. At present Iranian production is approximately 6 million barrels per day because of the energy requirements of the industrial countries. They explained that Iran is pursuing this production policy despite the fact that the surplus foreign exchange generated and invested abroad is earning a negative real rate of return due to the high rate of world inflation. The Iranian Government, however, is aware of the close interdependency existent in the world economy and the probability that economic difficulties abroad would harm Iran's own development efforts.

The Iranian representatives stated that for 1974/75 receipts from the oil sector, on a cash basis, are expected to approach SDR 17 billion. With respect to 1975/76 it is estimated that these receipts will increase to about SDR 18-20 billion depending upon price developments and assuming only a marginal (3-4 per cent) increase in output.

2. Development policy

The sharply expanded oil revenues have considerably increased the resources available for financing development expenditures, and as a result the Fifth Plan (1973/74-1977/78) is being revised.1/ The primary objective of the Plan continues to be the achievement of a high rate of economic growth. During the intragovernmental discussion on the proposed revisions, specific criteria were established to determine which sectors of the economy would receive priority. Firstly, considering Iran's comparative advantage, the petroleum and petrochemical sectors have been assigned high priority. Secondly, it is clear that considerable investments are required to overcome the anticipated bottlenecks in the ports, transportation system, the power sector, and in the supply of construction materials. Thirdly, the agriculture sector has been selected for special emphasis since industrial expansion requires greater agricultural inputs and expanded production of foodstuffs will be needed to meet the increased demand for food engendered by rising incomes and high income elasticities. There are, however, physical constraints confronting increased production from agriculture, particularly the supply of water. Despite the planned accelerated development of agriculture it is unlikely that self-sufficiency in food will be achieved in the future, and Iran is expected to continue relying on imported food to meet domestic demand.

The mission inquired about the nature of the bottlenecks which might constrain the rate of disbursement of development expenditures and project implementation and the measures taken to alleviate these difficulties. The Iranian representatives responded that the limited supply of skilled manpower has been singled out as the major limiting factor. The skilled manpower gap is estimated at about 700,000 over the Fifth Plan period. Steps are being taken to try to overcome this constraint, which include better utilization of existing manpower resources, employment of foreign skilled labor, both as actual participants in the labor force and for training Iranian personnel, and contracting out some projects to foreign firms who will supply their own labor. Additionally, since the greatest increase in the demand for labor is coming from the private sector, the Government is offering financial inducements to that sector to expand or organize its own labor training programs. The increased demand from the private sector for administrative talent is also manifest in a net outflow

1/ The Iranian authorities estimate the average annual growth rate in real resource availabilities during the Fifth Plan at nearly 26 per cent. This estimate includes an adjustment to take into consideration the impact of the improvement in the terms of trade resulting from the steep increase in the prices of petroleum exports. Excluding that factor, the implied real growth rate of the GDP during the same period is estimated to average approximately 14 per cent per annum.

of experienced administrators from government service. Furthermore, shortages in certain categories of labor have already been reflected in rising wage levels.

The Iranian representatives continued that with respect to physical bottlenecks the major problem is the time required for the completion of new undertakings in port and transportation infrastructure. New port facilities scheduled for construction during the Plan will not be operational until the end of the Plan period. In the interim, techniques have been introduced to increase the capacity of existing port facilities and by the end of the Plan period the completion of new facilities will raise port capacity sharply.

Another major objective of the revised Plan is to accelerate the rise in the standard of living of the Iranian people. The Iranian representatives explained that new social programs to be introduced during the Fifth Plan period include free primary education, a nationwide preventive health program and increased subsidies for basic foodstuffs. Each of these programs will have a considerable impact upon expenditures over the Plan period, but the magnitude of the impact cannot yet be accurately gauged.

The mission commented that given the existing bottlenecks a too high level of domestic expenditure would result in rising domestic prices and thereby inflate the cost of investments. The Iranian representatives agreed that rising domestic prices would increase the investment bill in nominal terms for a given set of projects. Nevertheless, the Government is willing to pay this price in order to make use of the opportunity for accelerated development which has been provided by the increase in oil revenues. The authorities believe that sufficient domestic productive capacity should be established in certain major areas and the longer the expansion of these basic industrial sectors is postponed the more costly their development will become.

3. Fiscal policy

Recent developments in government finances have been dominated by the sharp increases in the oil revenues. In 1973/74, oil revenues increased by 76 per cent to Rls 311 billion and exceeded budget estimates by Rls 85 billion.1/ The additional oil revenues constituted the primary cause for the sharp reduction in net financing from the banking system to Rls 13 billion and for the reversal from considerable net external borrowing to a small net repayment.

The original budget estimates for 1974/75 were formulated in the autumn of 1973 prior to the announcement of the steep increase in oil prices. The estimates projected about a 45 per cent increase in revenues,

1/ The par value of the Iranian rial is SDR 1 = Rls 82.2425. The Iranian rial is pegged to the U.S. dollar; the buying rate for the U.S. dollar is US$1 = Rls 67.50.

nearly a 50 per cent rise in total expenditures, and an overall deficit of about Rls 46 billion (see Table 1). The new oil situation in 1974 changed the fiscal picture dramatically. The revised estimate of oil revenues at Rls 1,350 billion is 175 per cent higher than the original estimate. In view of the greatly expanded oil revenues the authorities decided to increase current and investment expenditures by 67 per cent and 61 per cent, respectively, relative to the original estimates or by over 150 per cent for either as compared to the actuals in 1973/74. Despite the steeply higher revised expenditure target, the overall budgetary position is projected to be in surplus of about Rls 300 billion which would be invested abroad.

Table 1. Summary of Government Finances

(In billions of Iranian rials)

Year ended March 20	1973/74 Prelim. Actuals	1974/75 Budget Estimates	1974/75 Revised Estimates	1975/76 Budget Estimates
Revenues	484.4	700.3	1,548.8	1,773.7
Oil revenues	311.3	491.0	1,349.6	1,478.8
Other	173.1	209.3	199.2	294.9
Expenditures	497.7	746.1	1,252.7	1,555.6
Current and special	336.5	500.8	824.7	1,039.9
Fixed capital	161.2	266.6	428.0	515.7
Surplus or deficit (-)	-13.3	-45.8	296.1	218.1
Financing and investments	18.7	45.8	-296.1	-218.1
Net external	-2.6	45.8	-301.5	-182.3
Net domestic	21.3	--	5.4	-35.8
Discrepancy	-5.4	--	--	--

Source: Plan and Budget Organization.

Note: For explanatory footnotes see Recent Economic Developments (Table 22) to be issued shortly.

The mission inquired whether the Iranian authorities expected actual cash disbursements to reach the projected levels and whether the foreign exchange component of expenditures in 1974/75 would be higher than in the preceding year. The Iranian representatives stated that, based on disbursements during the first seven months of the fiscal year, the projected level of current expenditures is expected to be reached, but fixed capital expenditures will not exceed Rls 390 billion due to delays in project implementation. However, the Iranian representatives added that some of the disbursements would merely represent transfers from the Treasury to deposit accounts of other government agencies. Concerning the foreign exchange component of expenditures, the Iranian representatives estimated that at least 40 per cent of total expenditures in 1974/75 will be incurred in foreign exchange which contrasts with a foreign exchange component of about 30 per cent in 1973/74.

A major factor contributing to the growth in expenditures, the Iranian representatives explained, was the sharp rise in import prices. In addition, the revised estimates included the effects of both tax and expenditure programs designed to offset the rise in the cost of living such as the reduction in tariffs and commercial benefit taxes and the subsidization of basic foodstuffs. Tax measures have been introduced to increase after-tax income, and the reduction in tax rates for public sector employees has been greater than for the private sector. This relative increase in civil service disposable income is aimed at improving the public sector's competitive position in the labor market.

Based on these expectations for 1974/75 a considerable shortfall in total cash expenditures is expected, reflecting partly the transfers which result in the buildup in deposits of government agencies and in part a shortfall in capital expenditures from the target in the budget. This implies that the overall fiscal surplus will substantially exceed the Rls 300 billion in the revised estimates. The mission observed that despite the expected shortfalls in cash disbursements and even after allowing for the fact that the foreign exchange component in 1974/75 will rise considerably, the projected expansion in the Government's net domestic expenditures appears to be excessive and may add considerably to pressure on domestic resources. The Iranian representatives stated that it is hoped that the rise in private demand which is stimulated by expanding government expenditures would be largely matched by an increased flow of goods and services from abroad and for that purpose substantial adjustments in the balance of payments policies have been introduced (see below). Furthermore, more moderate expenditure growth targets are planned for 1975/76. The expansion of oil revenues is projected to slow down substantially, and both current and fixed capital expenditures are projected to increase by about 30 per cent. Thus the surplus, while substantial, is anticipated to be considerably smaller than in 1974/75. Net foreign investments, lending and loan repayments are forecast at nearly Rls 200 billion. The authorities noted that a tax reform is under consideration with the long-term objective of expanding the tax base to support continued growth in government budgetary operations after oil revenues stabilize in future years.

4. Banking and monetary policies

During 1973/74 two new specialized banks were set up, and in 1974/75 a seventh specialized bank was established by private interests, mainly to help in the financing of large construction projects. Also three new commercial banks began operating in 1973/74. The monetary authorities believe that Iran is now sufficiently provided with commercial banking services. However, in line with the policy of decentralizing the development process and increasing local participation, seven independent regional development banks have been planned. The authorities intend to improve the supervision of the commercial banking system. Measures have been introduced restricting the amount of borrowing from banks by their owners or by any single company or institution. Furthermore, the authorities have taken other measures to strengthen the banking system as they believe that it would be desirable to increase the banks' capitalization in view of rapidly expanding banking activity.

In 1973/74 the total of money and quasi-money increased by 29 per cent while the real growth rate in the economy was about 14 per cent and prices increased by about 13 per cent. The mission noted that the rate of price increases accelerated in 1973/74 from approximately 6 per cent in the previous year, and price pressures have continued during the first half of 1974/75. The Iranian representatives explained that in part this resulted from higher import prices. In order to ameliorate the impact of external factors on the domestic price level, the authorities introduced at mid-year price control measures, and subsequently the Government expanded its price stabilization program to include price subsidies for basic foods. In addition the authorities instituted measures to expand the flow of imports at lower costs. The policy adjustments included providing increased credit for imports. Although the expansion of credit to the private sector was controlled by quantitative ceilings imposed on each bank, the increase in private sector credits in 1973/74 was somewhat larger than planned partly because the Bank Markazi permitted, beginning September 1973, preferential credit facilities for importers in order to facilitate the flow of imports.

The mission observed that monetary developments during the first half of 1974/75 and the anticipated fiscal and balance of payments results for the year as a whole appeared to suggest that an acceleration in the rate of monetary expansion in 1974/75 is likely. Data for the first six months showed an increase in domestic liquidity of 19 per cent compared to 10 per cent in the like period of the previous year (see Table 2). The Iranian representatives said that based on the projected balance of payments and fiscal results in 1974/75 they estimated an increase in domestic liquidity of over 40 per cent in this year. The private sector's credit needs in 1974/75 are estimated at about 40 per cent over the March 1974 level which implies an increase of approximately Rls 200 billion. However, as the reduction in the import deposit requirements is estimated to release about Rls 40 billion in liquidity to the private sector, an increase in bank credit of about Rls 160 billion should prove adequate.

Table 2. Factors Affecting Changes in Money and Quasi-Money

(In billions of Iranian rials)

Year ended March 20	1972/73	1973/74	First six months 1973/74	First six months 1974/75	Projec. 1974/75
Money and quasi-money	103.0	116.4	40.6	99.6	220
Money	41.6	44.0	18.5	32.0	...
Quasi-money	61.4	72.4	22.1	67.6	...
Foreign assets (net)	32.9	52.2	-14.7	281.5	486
Domestic assets (net)	70.1	64.2	55.3	-181.9	266
Claims on private sector	84.7	126.7	55.3	83.3	160
Claims on public sector (net)	12.8	-0.8	27.1	-215.5	-352
Other items (net, increase -)	-27.4	-61.7	-27.1	-49.7	-74
Changes in per cent					
Money and quasi-money	(35)	(29)	(10)	(19)	(43)
Claims on private sector	(31)	(35)	(15)	(17)	(33)

Source: Bank Markazi Iran.

The mission commented that an increase in domestic liquidity at a rate of over 40 per cent would accentuate the upward pressures on prices. The credit policy vis-a-vis the private sector seemed appropriate. An adjustment in the anticipated rate of monetary expansion would, therefore, require a reduction in the planned level of the Government's net domestic expenditures.

The interest rate structure was raised in September 1973 and since then bank loan rates also increased. The Iranian representatives observed that given the limitation on credit expansions in conjunction with continued strong demand for credit, it was to be expected that interest rates would move upward. The prime loan rate from commercial banks peaked at 13-15 per cent during the year but subsequently eased to 12-14 per cent currently. The Iranian representatives expressed concern over the increasing differential between interest rates abroad and in Iran and the possibility that this spread might result in capital inflows. The appropriate monetary measures to control such an inflow were still under consideration.

5. Balance of payments developments and prospects

In 1973/74 Iran's current account recorded the first surplus in about a decade as an 80 per cent increase in foreign exchange receipts of the oil sector substantially exceeded the growth in import and other payments (see Table 3). The current account surplus combined with substantial net official borrowing abroad resulted in more than doubling the overall surplus to nearly SDR 0.9 billion.

Table 3. Summary of Foreign Exchange Receipts and Payments

(In millions of SDRs)

Year ended March 20	1972/73	1973/74	Estimated 1974/75	Forecast 1975/76
A. Receipts from the oil sector	2,370	4,273	16,910	17,820
B. Other goods and services (net)	-2,486	-3,886	-6,880	-9,280
Exports	427	527	660	830
Imports	-2,754	-4,112	-6,880	-9,120
Private sector	(-1,446)	(-2,239)	(-3,730)	(-4,560)
Public sector	(-1,308)	(-1,873)	(-3,150)	(-4,560)
Services (net)	-159	-301	-660	-990
C. Total (A+B)	-116	387	10,030	8,540
D. Official loans and credits (net)	480	633	-3,480	-5,140
Drawings	899	1,082	410	160
Repayments and prepayments	-419	-449	-1,160	-1,160
Advance payments for imports	--	--	660	-410
Loans and investments	--	--	-2,070	-3,730
E. Errors and omissions	21	-135	--	--
F. Total (C+D+E)	385	885	6,550	3,400
G. Monetary movements (increase in assets -)	-385	-885	-6,550 1/	-3,400

Source: Bank Markazi Iran.

1/ Includes lending to the Fund under the Oil Facility.

Mainly due to the steep increase in oil prices, the net foreign exchange earnings of the oil sector are expected to rise to nearly SDR 17 billion in 1974/75 and are forecast to approximate SDR 18 billion in 1975/76. In view of the vast expansion in foreign exchange availabilities, the Iranian authorities have made substantial adjustments in their balance of payments policies. A considerable reduction in import taxation and in quantitative import restrictions has been implemented (see Section 6 below) and all the remaining restrictions on access to foreign exchange have been effectively eliminated (see Section 7 below). The effect of these measures is expected to be reflected in an estimated 67 per cent increase in import payments in 1974/75 to be followed by a forecast 33 per cent rise in 1975/76. The Iranian representatives explained that the higher growth rate for 1974/75 results partly from a change in 1974/75 in the mode of payment for imports from foreign credits to cash and in part from assuming a considerably slower rate of import price increases in 1975/76. In addition to measures affecting current transactions, the authorities reversed the policies governing the official capital account. New borrowing commitments have been substantially curtailed and limited to only those cases where foreign participation (mainly IBRD) is beneficial for technical reasons. Repayments on the external debt have been accelerated. Substantial public sector advance payments for imports are being made, and the disbursements of loans and investments is expected to total about SDR 5.8 billion over the two years ending in March 1976. The net result of all these factors is an overall balance of payments surplus of SDR 6.6 billion in 1974/75 falling to SDR 3.4 billion in 1975/76.

The mission noted that Iran is making rapid progress in effecting adjustments in its external accounts which are highly desirable from the point of view of the international community and inquired about reserves management policy. The Iranian representatives stated that reserves management policy is guided by consideration of safety, geographical distribution and terms. Currently, external assets are not invested in instruments with maturity in excess of one year, although in some cases the bank has indicated to borrowers that deposits or loans would be renewed. At the end of December 1974 Iran's reserves stood at SDR 6.85 billion, equivalent to one year's imports at the estimated 1974/75 level.

6. Commercial policy

The Iranian representatives stated that during 1974/75 several measures had been taken: the import registration fee was reduced from 5.5 per cent to 1 per cent; commercial benefit taxes were either eliminated or reduced on a wide range of goods, and customs duties on many goods were reduced; several items on the "unauthorized" list were shifted to the "authorized" list; the import of certain items which previously required the approval of the Ministry of Commerce was to be allowed without approval; the import deposit requirement rates were reduced to a flat 15 per cent (previously 100 per cent, 40 per cent or 15 per cent); and, in addition, most food items became exempt from the import deposit requirement. The Iranian representatives explained that these reductions in import taxation and the lifting of quantitative restrictions were aimed at increasing supplies in the market. In addition, considerable subsidization of imported foodstuffs was being undertaken to moderate the impact of higher import prices. The mission estimated the impact of the reduction in import costs as equivalent to a 10-12 per cent decrease in the landed value of imports. The Iranian representatives estimated that the decrease in import costs probably approached 15 per cent if greater weight is taken of the impact of food subsidization. Iran continues to maintain quantitative restrictions on some imports for protective reasons as in some cases using cost restrictions alone is not sufficient to prevent excessive penetration into the Iranian market.

On bilateral payments agreements, the Iranian representatives confirmed that three new payments agreements (with the People's Republic of China, North Korea and Eastern Germany) were concluded and came into effect since the last consultation discussions. The Iranian representatives explained that under the new payments agreements the Iranian rial is used as the currency of denomination; otherwise the terms of these agreements are mostly the same as those of the other arrangements. The Iranian representatives stated that Iran needs to maintain and expand bilateral payments arrangements with the Eastern European countries and the People's Republic of China in order to secure additional export markets, especially for industrial products. Iran has a bilateral payments agreement with one Fund member, Romania. The mission expressed the hope that Iran would cooperate with Romania in terminating this arrangement as soon as practicable. The Iranian representatives stated that for some time Iran's trading relations with Romania have been conducted through the use of a trade and payments arrangement, and it is difficult to terminate this arrangement in a short period of time. Iran continues to maintain the RCD clearing arrangements with Pakistan and Turkey.

The mission stated that Iran has made commendable progress in removing trade restrictions and expressed particular interest in Iran's import liberalization measures as a means of adjusting its external payments position. It hoped that further progress will be made for the benefit of both Iran and the international community. The mission also drew the attention of the Iranian authorities to the Managing Director's letter to Fund members inviting them to subscribe to the "Declaration on Trade Measures." The Iranian representatives stated that they would consider the matter and would respond to the Fund as soon as a decision is made.

7. The exchange system

In January 1974 the Central Bank authorized two exchange markets, a commercial (or official rate) market and a noncommercial (or free rate) market. The official rate applies to foreign exchange proceeds of the public sector (mainly oil revenues) and import payments. Invisible payments and capital transactions unauthorized for the official market are effected at the free rate. All other transactions may take place in either market. This arrangement effectively eliminates all the remaining exchange restrictions on current international payments as customers are permitted unlimited access to the noncommercial market for any purpose. At the start of the new exchange system the free rate of rials for the U.S. dollar (the intervention currency) depreciated by about 1 per cent relative to the official rate. However, since June 1974 the quotations for the U.S. dollar in both markets have been identical. The Iranian representatives stated that through the introduction of these exchange arrangements, to be supplemented by additional measures that might be required, the authorities hope to create an international money market in Tehran.

The mission, noting with satisfaction that Iran has effectively eliminated all remaining restrictions on current international payments, transfers, and on capital flows, enquired about the Iranian authorities' policy with regard to management of the noncommercial rate. The Iranian representatives stated that the structure of the two markets will ensure that the rates do not deviate from each other. So far exchange rates of the rial for the U.S. dollar in both commercial and noncommercial markets have remained within the wider margin limits, and the spread between the most appreciated buying rate for the U.S. dollar and the most depreciated selling rate for that currency have so far remained within 2 per cent. It is the intention of the authorities to operate the markets in such a manner that rates remain within the permissible margins and spread. This policy would apply under normal circumstances, but the Iranian authorities cannot rule out a possibility that the two rates might deviate in certain exceptional circumstances, such as when a sudden and large inflow or outflow of capital occurs. The authorities would then have to consider what measures would be appropriate and necessary. The mission stated that in case exchange rates should move beyond the permissible margins and/or spread the Iranian authorities would be obligated to notify the Fund and to seek its approval.

Other changes in the exchange system include the permission, granted in September 1974 to the commercial and specialized banks authorized to deal in foreign exchange, to import and export gold and silver and to sell these metals to any person in Iran; previously imports of nonmonetary gold had been made only by Bank Melli Iran and exports had been prohibited. Also, in October 1974, the Central Bank authorized export contracts denominated in Iranian rials. Some rial denominated contracts for exports to the Persian Gulf area have been contracted.

III. Staff Appraisal

The economy of Iran, which has been experiencing rapid broad-based growth, now faces new challenges and opportunities. The major factor accounting for a highly favorable situation is the vast expansion in the availability of resources resulting from the steep increase in oil revenues. The policy of the Iranian authorities is to utilize these resources, with a minimum of delay, to accelerate the economic development of the country. To implement this policy objective, the Iranian authorities have increased sharply their current and capital expenditure plans for 1974/75 and beyond, but more moderate increases are intended for 1975/76. However, the absorptive capacity of the economy is unavoidably limited by certain bottlenecks, mainly an acute shortage of skilled labor and capacity limitations in the port and in the inland transport systems. The authorities have taken some measures to ease the supply constraints in the short-run and to expand the economy's absorptive capacity over the longer-run. The authorities are aware that the critical factor in this regard is the labor shortage as it affects the growth prospects of the economy.

The Iranian authorities will need to reconcile the objective of accelerated development with a tolerable level of inflation at home. Price increases have accelerated in the recent past despite substantial measures designed to cushion the impact of rising prices abroad on the domestic price level. Given the existing physical constraints an increase in total demand beyond a certain level will cause severe pressures on domestic resources. Since the Government's net domestic fiscal operations constitute the primary source of increased demand in the economy, adjustments might be required, particularly in the level of government expenditures.

An essential ingredient for the success of the policy of accelerating economic development in Iran while avoiding severe inflationary pressures is a substantial expansion in the flow of goods and services from abroad. Iran is fortunate in that its domestic and external financial policy objectives are not in conflict; therefore the Iranian authorities are in a position to make considerable adjustments in their balance of payments policies. All restrictions on access to foreign exchange have been eliminated and quantitative and import cost restrictions have been reduced. These measures have been quite successful in stimulating import demand and in facilitating the flow of goods and services to Iran. However, despite the large increase in current payments, Iran's current account is expected to remain in strong surplus. Consequently, the authorities have initiated a large program involving external loans and investments. As a result of these policies the overall balance of payments surplus is expected to decline considerably in 1975/76. Iran's balance of payments policies are thus helpful to the international community as a whole in the present circumstances.

IV. Proposed Decision

The following draft decision is submitted for the consideration of the Executive Board:

1. This decision is taken by the Executive Directors in concluding the 1974 consultation with Iran pursuant to Article XIV, Section 4, of the Articles of Agreement.

2. The Iranian economy, stimulated by expanding government expenditures and vigorous activity in the private sector, has been experiencing rapid broad-based growth. Price increases, however, accelerated in 1973/74 partly reflecting external factors. The balance of payments recorded substantial and rising surpluses mainly as a consequence of the sharp increase in oil receipts.

3. The Iranian authorities are planning to accelerate the development of the economy. Toward this end, they have made substantial adjustments in their balance of payments policies and have taken steps to ease supply constraints. Despite these measures, the projected large increase in the Government's net domestic expenditures might lead to intensification of pressures on domestic resources. The Fund believes that the authorities should keep in view the need to adjust their expenditure plans in line with the absorptive capacity of the economy.

4. Iran's strong balance of payments position has permitted the effective elimination of all exchange restrictions, considerable reduction in import cost and quantitative restrictions, and the initiation of a large public external program of loans and investments. These measures are expected to achieve a considerable reduction in Iran's overall

external payments surplus in 1975/76. The Fund believes that these policies are appropriate in the present circumstances. The Fund hopes that Iran will take steps to terminate its bilateral payments agreement with a Fund member and will continue its policy of reducing the degree of import protection.

Fund Relations with Iran

Iran joined the Fund in 1945 with an original quota of SDR 25 million. The present quota of SDR 192 million became effective in November 1970. The par value for the Iranian rial was changed, with Fund concurrence, in September 1972 from SDR 1 = Rls 75.75 (equivalent to 0.0117316 gram of fine gold) to SDR 1 = Rls 82.2425 (equivalent to 0.0108055 gram of fine gold).

Iran has had several transactions with the Fund, including some under two stand-by arrangements. All transactions in recent years have been within the gold tranche. Iran's most recent transaction was a repurchase under Article V, Section 7(b) equivalent to SDR 28.74 million effected in January 1973 which reduced the Fund's holdings of Iranian rials to the present level of 75 per cent of quota.

Iran is a participant in the Special Drawing Account and has received a total of SDR 61.9 million from three allocations. As of December 31, 1974 Iran had used SDR 40 million to obtain currency and SDR 1.9 million with the General Account. Under designation Iran has provided currency totaling the equivalent of SDR 24.5 million. On December 31, 1974 Iran's holdings of special drawing rights totaled SDR 44.5 million, equivalent to 72 per cent of net cumulative allocations.

The Fund has a borrowing agreement with Iran for the equivalent of SDR 580 million in order to finance purchases under the oil facility. As of December 31, 1974 the equivalent of SDR 374 million of this amount had been used.

The 1973 Article XIV consultation discussions took place in Tehran in June 1973 (SM/73/209, August 22, 1973; and Supplement 1, October 19, 1973). The Executive Board's Decision (Decision No. 4082-(73/103), adopted at Meeting 73/103, November 5, 1973) was as follows:

1. This decision is taken by the Executive Directors in concluding the 1973 consultation with Iran pursuant to Article XIV, Section 4, of the Articles of Agreement.

2. The Iranian economy has expanded at a very rapid pace during the past two years. The balance of payments recorded substantial surpluses while price increases were moderate. These favorable developments reflected the sharp increase in oil receipts and vigorous activity by the private sector. However, monetary expansion in 1972/73 was somewhat excessive.

3. While the medium-term prospects are favorable, Iran is currently facing substantial inflationary pressures. The authorities have responded to these pressures by increases in interest rates and by other constraints on credit to the private sector. Some of the pressures will be absorbed by the unusually sharp increase in imports that is taking place. However, the Fund

believes that adjustments in fiscal policy designed to reduce the reliance of the budget on domestic bank financing in 1973/74 would be helpful in controlling inflationary pressures.

4. Iran's total external debt has grown rapidly in recent years although debt service is declining as a proportion of external receipts. The authorities have recently improved debt control procedures. While welcoming this development, the Fund hopes that debt control policy will be firmly carried out.

5. Iran continues to pursue liberal payments policies, but accords substantial protection to domestic industry in the form of import restrictions and import taxation. In the recent past, the authorities have relaxed considerably the restrictions on current invisible payments. The Fund hopes that Iran will take steps to modify its bilateral payments agreement with a Fund member with a view to its eventual elimination. The Fund notes that increased attention is being given to the appropriateness of protective policies and that the degree of protection has been reduced in some cases.

Iran: Basic Data

Area and population	
Area	1,648,000 square kilometers
Population	33.1 million (1974)
Annual population growth	3.1 per cent (estimate)
GNP per capita (current prices) 1973/74	US$780
IMF data	
Par value	Rls 82.2425 = SDR 1, equivalent to Rls 68.17 = US$1
Quota	SDR 192 million
Fund holdings of rials (end of December 1974)	75 per cent of quota
Lending to the Fund (end of December 1974)	SDR 374 million
SDR allocation	SDR 61.9 million
SDR holdings (end of December 1974)	SDR 44.5 million (72 per cent of net cumulative allocation)

Year ended March 20	1971/72	1972/73	1973/74
	(In billions of Iranian rials)		
National accounts (at constant 1959/60 prices)			
Non-oil GDP, of which:	588.1	663.7	757.2
Agriculture	(120.5)	(131.3)	(138.9)
Industry	(166.5)	(190.8)	(226.9)
Services	(301.1)	(341.6)	(391.4)
Oil sector contribution to GDP	219.5	238.6	275.8
GNP (at market prices)	757.9	855.6	970.9
(Rate of growth in per cent)	(9.9)	(12.9)	(13.5)
Price indices (1969/70 = 100)			
Wholesale prices	110.7	117.0	132.3
Cost of living	107.1	113.8	126.5

Year ended March 20	1971/72	1972/73	1973/74 Prelim. actuals	1974/75 Revised budget estimate
	(In billions of Iranian rials)			
Government finances				
Revenues	270.3	317.1	484.4	1,548.8
Oil revenues	(155.6)	(176.9)	(311.3)	(1,349.6)
Other revenues	(114.7)	(140.2)	(173.1)	(199.2)
Expenditures	297.4	371.5	497.7	1,252.7
Current expenditures	(182.3)	(239.7)	(336.5)	(824.7)
Fixed capital expenditures	(115.1)	(131.8)	(161.2)	(428.0)
Overall surplus or deficit (-) 1/	-27.1	-54.4	-13.3	296.1
External financing (net)	(15.3)	(10.7)	(-2.6)	(-301.5)
Domestic financing (net)	(-1.6)	(28.2)	(21.3)	(5.4)

Year ended March 20	1971/72	1972/73	1973/74
	(In billions of Iranian rials)		
Money and credit (changes)			
Money and quasi-money	61.7	103.0	116.4
(Change in per cent)	(26)	(35)	(29)
Credit to private sector	47.4	84.7	126.7
(Change in per cent)	(21)	(31)	(35)
Credit to public sector (net)	-13.1	12.8	-0.8
Of which: National Government	(-7.7)	(23.4)	(13.2)
	(In millions of SDRs)		
Foreign exchange receipts and payments data			
Receipts from the oil sector	2,184	2,370	4,273
Non-oil exports	357	427	527
Imports	2,514	2,754	-4,112
Services (net)	-185	-159	-301
Nonmonetary capital (net) 2/	638	501	498
Monetary movements (increase -)	-480	-385	-885
Foreign assets (end of period)			
Central bank gross foreign assets	675	909	1,686
Central bank net foreign assets	372	837	1,708
Commercial banks' net foreign assets	16	-64	-50

1/ Overall surplus or deficit differs from total financing due to data discrepancies.

2/ Including net errors and omissions.

Office Memorandum

TO : The Managing Director
The Deputy Managing Director

DATE: January 15, 1975

FROM : J. W. Gunter JWG

SUBJECT : Iran: Draft Staff Report on 1974 Article XIV Consultation

Attached for your consideration and approval is the draft of the Staff Report on the 1974 Article XIV consultation with Iran. This draft has been cleared with the concerned departments.1/ The Board's discussion of this report is expected to take place during February 1975.

1/ ETR: Mr. Mookerjee
Legal: Ms. Lachman
FAD: Mr. Redford
Research: Mr. Gurfinkel
and Mr. Bouter
TRE: Mr. Miller
Bureau of Statistics: Mr. Hammoud

xx

Mr. Homayoun

Markazbank, Tehran, Iran

If comments on minutes of recent discussions have not been airmailed would it be possible for the Governor to bring them with him?

Regards

HITTI
INTERFUND

S. Hitti/JMS

MED

1.8.75

Director

CONFIDENTIAL

The Managing Director
The Deputy Managing Director

November 29, 1974.

S.H. Hitti

Iran - 1974 Article XIV Consultation

A staff mission headed by Mr. John W. Gunter and consisting of Messrs. Jakubiak and myself of the Middle Eastern Department, Iura of the Exchange and Trade Relations Department, and Floyd of the Fiscal Affairs Department conducted, during the period November 16-23, the 1974 Article XIV Consultation discussions with Iran. During the same period Mr. Gunter held special consultation discussions with the Iranian authorities and his report on these discussions has already been submitted to you. The recent consultation discussions with Iran were the first held since the dramatic changes in the international oil situation were initiated late in 1973. The discussions, therefore, centered on the impact of these developments on the economic and financial policies of Iran and the main conclusion that emerged was that Iran was making a more rapid balance of payment adjustment than had been foreseen earlier.

The Iranian authorities believe that petroleum prices, which should never be less than the cost of production of oil substitutes, should be related to the prices of the major commodities imported by the oil producing countries. Furthermore, they are of the opinion that the present complex pricing structure should be replaced by a considerably simpler pricing system. Iran intends to submit its proposal for indexing oil prices and for a uniform price system for discussion at the forthcoming December meeting of the OPEC. With respect to production levels, the Iranian representatives stated that an output of about 4 million barrels per day would be sufficient to meet Iran's financial requirements. Therefore, Iran would welcome conservation measures in consuming countries that would help in reducing Iranian output from the present level of about 6 million barrels per day.

Iran's oil revenues are estimated to exceed $20 billion in 1974/75 (Iranian year ended March 20). Recent policies of the Iranian authorities are geared, directly and indirectly, to a substantial absorption of the expanded oil revenues in a relatively short period of time. In the first instance, it is intended to maintain a high level of expansion in the economy, estimated at about 15 per cent per annum in real terms. This is to be stimulated mainly through sharply rising government current and investment expenditures. The Government's cash outlays are expected to increase by about 80 per cent or more in 1974/75 and to rise by a further 40-50 per cent in 1975/76. In the second place, the authorities have effectively eliminated all the remaining restrictions on access to foreign exchange (see below). Thirdly, they have instituted measures which decreased the landed cost of imports by about 10-12 per cent and which are expected to result in a higher level of effective demand for imports. In addition, quantitative restrictions on imports maintained for protective reasons have been reduced. Fourthly, the authorities have sharply curtailed external borrowing, accelerated repayments on the external debt, and made commitments, so far, for foreign loans and investments of about $7.6 billion and a further increase in these commitments is anticipated. In addition, the Government is making advance payments for some imports.

The effectiveness of these policies in increasing the flow of goods and services to Iran is unavoidably limited by the existence of certain bottlenecks, mainly the shortage of skilled labor and limitations in port capacity and in the inland transport system. Emergency measures have been introduced which are achieving a higher level of flow than under normal conditions, and priority is being given to overcoming these bottlenecks. The impact of these policies on the balance of payments is expected to be reflected in a reduction in the estimated overall surplus from about $7 billion in 1974/75 to approximately $4 billion in 1975/76. This decrease in the surplus is anticipated due to a forecast moderate growth in oil revenues, considerable rise in current payments and a further expansion in net outflow of official capital.

The mission expressed the view that as the maximum possible was being done to increase the flow of goods and services from abroad, an undue increase in total domestic demand would result in pressures on domestic resources leading to price increases. In 1973/74 prices increased by about 13 per cent despite substantial measures designed to cushion the impact of price increases abroad on the domestic price level. The Government's net domestic operations was resulting in such a level of liquidity injection into the economy that the Central Bank's policy with respect to credit to the private sector was being enforced mainly through quantitative ceilings on credit expansion by the commercial banks. While the policy pertaining to the expansion of credit to the private sector is appropriate, excessive monetary expansion could still arise in 1974/75 reflecting a too high level of government net domestic expenditures. Consequently, adjustments might be required relating to the level of expenditures by the Government.

In January 1974 the Central Bank authorized two exchange markets, a commercial (or official rate) market and a noncommercial (or free rate) market. Unlimited access to the free market for any purpose effectively eliminated all exchange restrictions. At the start of the new exchange system the free rate of the U.S. dollar (the intervention currency) was depreciated by about 1 per cent relative to the official rate. Over a period of time the free rate moved closer to the official rate and since June the rate quotations for the U.S. dollar in both markets have been identical. Except during a brief period immediately after the introduction of this exchange system, the Central Bank has not provided any foreign exchange to the free market, nor purchased from it. Regarding the Iranian authorities' policy for the management of the noncommercial rate, the mission was informed that the structure of the two markets would ensure that the rates would not deviate from each other. Furthermore, it is the intention of the authorities to operate the markets in such a manner which will result in the observance of the wider margins and the 2 per cent spread between buying and selling rates. While this policy will apply under normal circumstances, the Iranian authorities could not rule out the possibility that the two rates might deviate in certain exceptional circumstances, such as when a sudden and large inflow or outflow of capital occurs. In this connection, the Iranian representatives stated they were aware of Iran's obligations under the Fund's Articles of Agreement.

The Iranian representatives stated that, for the time being, Iran intended to maintain its Article XIV status in the Fund. Regarding the "Declaration on Trade Measures," the Iranian authorities had this matter under consideration.

cc: Mr. Sturc
Mr. Gold
Mr. Polak
Mr. Habermeier
Mr. Goode
Mr. Teyssier
Mr. Hicks
Mr. Mladek
Mr. Ray
Mr. Gunter — Central Division
Mr. Gerakis — Coastal Division
Mr. Hassanein — Eastern Division
Mr. Von Post — Western Division
Mr. Selehdar
Mr. Floyd
Mr. Iura
Mr. Jakubiak

Mr. Gunter

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Office Memorandum

(copy to Mr. Ray)

TO : Mr. Goode

DATE: November 27, 1974

FROM : Robert H. Floyd

SUBJECT : Back to Office Report--Article XIV Consultation and GFS Missions to Iran

1. On November 25, 1974 I returned to office after a month's combined GFS and Article XIV consultation mission to Iran headed by Mr. John Gunter, Acting Director of the Middle Eastern Department. The mission was well received by the Iranian authorities and received good cooperation in all areas of work.

2. Economic developments in Iran during 1973/74 (the Iranian calendar and fiscal years begin March 21) were dominated by rising foreign exchange receipts from the oil sector late in the year, but strong growth occurred in virtually all sectors of the economy. The real growth rate in GDP was about 14 per cent, and wholesale prices increased by about 13 per cent. The balance of payments showed a surplus of about US$1.0 billion. The budget deficit in 1973/74 was about Rls 19 billion, or about Rls 90 billion less than originally projected. Net domestic borrowing was about Rls 21 billion, while net repayments of foreign borrowing amounted to Rls 2 billion. Almost all of the reduced deficit resulted from additional oil revenues which totaled Rls 311 billion and exceeded the original budget estimate by Rls 85 billion. Non-oil revenues and current expenditures somewhat exceeded budget estimates, while fixed capital expenditures of Rls 167 billion (33 per cent of total expenditures) fell slightly short of original estimates. The rise in current expenditures was attributed primarily to the higher prices of domestic and imported goods, and the 38 per cent increase in tax revenues to the growth in the economy.

3. Final revisions of the 1974/75 budget are still under consideration, but the mission was provided with provisional estimates of revenue and expenditure aggregates. Oil revenues are projected to increase more than fourfold to Rls 1,353 billion, while non-oil revenues are expected to increase by a fifth to Rls 187 billion. Despite the growth in oil revenues, rapid increases in expenditures are expected to contribute to holding down the balance of payments surplus to about US$7 billion. Current expenditures are budgeted to increase by 160 per cent to Rls 823 billion and fixed capital expenditures by 170 per cent to Rls 451 billion. The budgeted surplus of about Rls 270 billion is to be absorbed by foreign loans and investments (Rls 180 billion) and repayments of foreign borrowing (Rls 90 billion). Nevertheless, the budget is likely to be the principal expansionary factor in the economy, and much of the policy discussion centered on the inflationary impact of rising government expenditures. Although precise data were not available on the foreign exchange component of government expenditures, the authorities estimated that about 40 per cent of expenditures in 1974/75 would be in foreign exchange, as compared with about 30 per cent in 1973/74. These proportions, together with estimated shortfalls in cash disbursements of about Rls 260 billion, imply that domestic expenditures will exceed domestic revenues by about Rls 400 billion in 1974/75, as compared with Rls 200 billion in 1973/74. The authorities are aware of the new problems presented by their additional financial resources

and have taken several measures to reduce the inflationary impact. Reductions of various import taxes, quantitative restrictions, and deposit schemes on imports have been introduced which the mission estimated would reduce the landed costs of imports by at least 10-12 per cent. Ports are an immediate physical bottleneck and are being operated on a full-time emergency basis. Public sector, and most private sector, imports are being paid for in cash and in advance to obtain lower prices, and subsidies on various basic foodstuffs have been introduced.

4. The proposed budget for 1975/76 projects oil revenues increasing by only 9 per cent to Rls 1,476 billion. Non-oil revenues are budgeted to increase by 50 per cent to Rls 282 billion, but the authorities indicated that this estimate was especially tentative and would depend on the outcome of a full-scale review of the tax system which had recently been begun. Both current and fixed capital expenditures are projected to increase by about 30 per cent and the budget surplus of Rls 134 billion is expected to be utilized in foreign loans and investments and foreign borrowing repayments. Partly as a result of the continuing rise in government expenditures, the staff estimates that the balance of payments surplus in 1975/76 will decline to about US$4 billion.

5. Work on the GFS project was undertaken with officials of the Plan and Budget Organization, the Ministry of Finance, and the Central Bank. The Plan and Budget Organization was especially well prepared for the mission, and prearranged meetings with an appointed committee from the Budget Bureau provided information more than sufficient to complete a revenue and functional expenditure classification for 1972/73 and to develop a good understanding of the structure of the public sector. Data on public enterprises and decentralized agencies for 1972/73 were provided. Some understanding of the Social Security Organization and data for 1973/74 was obtained, and the authorities have promised to forward data for 1972/73. An expenditure code exists which is sufficient to yield a good economic expenditure classification, but data are not now available since the code is not being fully utilized. The strong interest of the authorities at the Plan and Budget Organization is indicated by their adoption of a new revenue classification patterned after the GFS format. The officials at the Central Bank and the Ministry of Economic Affairs and Finance also appeared to be interested in the project (the Deputy Minister, H. Mehran instructed his subordinates to cooperate fully) but were obviously less prepared. Somewhat limited financing and debt data was obtained. Two appointments with the Treasurer were fruitful primarily in that they offered insight into the accounting, collection, and disbursement procedures and into the long existing discrepancies between monetary and fiscal data. These discrepancies arise primarily from the large number of ministerial accounts in the banking system that can be resolved only by a full reconciliation requiring considerable joint effort by officials of the Treasury and the Central Bank which was not feasible at this time. I believe that this system is likely to lead under current conditions of rapidly rising revenues and expenditures to an increasing discrepancy and to a cash management problem. The Vice Minister of Economic Affairs and Finance indicated that he expects to be the GFS correspondent and that he or a member of his staff will attend the Nairobi seminar. Since the Vice Minister's office is not immediately

concerned with either budgeting or accounting, I believe that it would be desirable for officials from the Plan and Budget Organization and the Central Bank to attend also. I expect that the Iranian authorities will continue to cooperate with the GFS project and will probably welcome future missions.

cc: Mr. Gunter
Mr. Radford
Mr. Hitti

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INTERNATIONAL MONETARY FUND

Iran: 1974 Article XIV Consultation

November 16-19, 1974

Tehran

List of Participants

Iranian Representatives

H.E. J. Amouzegar, Minister of Interior
H.E. M. Yeganeh, Governor, Bank Markazi Iran

Bank Markazi Iran

Mr. J. Shoraka, Deputy Governor
Mr. B. Homayoun, Vice Governor
Mr. S. Shirazi, Director General, International Banking Department
Mr. M. Tajdar, Director General, Economic Statistics Department
Mr. C. Towfiq, Director General, Economic Research Department
Mr. B. Zarringhalam, Deputy Director, Economic Research Department
Mr. M. Garadaghipour, Director, International Studies Department
Mr. M. Pesaran, Deputy, Economic Research Department
Mr. K. Ila, Chief, Money and Banking Division, Economic Research Department
Mr. B. Tamami, Chief, Balance of Payments Division, Economic Research Department

Ministry of Economic Affairs and Finance

Mr. H. Mehran, Senior Vice Minister for Economic Affairs and Finance
Mr. G. Ashrafi, Vice Minister for Investment and Foreign Assistance
Mr. A. Kooros, Vice Minister for Economic Affairs
Mr. A. Hozour, Economic Advisor
Mr. M. Shadman, Economic Consultant to the Senior Vice Minister for Economic Affairs and Finance

Plan and Budget Organization

Mr. C. Mejloumian, Undersecretary of State for Planning
Mr. M. Fardi, Director, International Economic Bureau

Ministry of Commerce

Mr. A. Memarzadeh, Vice Minister for Trade
Mr. M. Falsafi, Deputy Director General for Import-Export Regulations
Mr. F. Golsham, Deputy Director General for Foreign Trade

Fund Representatives

Mr. J.W. Gunter
Mr. S.H. Hitti
Mr. H.E. Jakubiak
Mr. R. Floyd
Mr. Y. Iura

Observer

Mr. J. Amuzegar, Executive Director

INTERNATIONAL MONETARY FUND

Iran: 1974 Article XIV Consultation

Minutes of Meeting No. 1

November 16, 1974

Tehran

Development planning

The mission observed that the recent sharp increase in the price of petroleum had expanded considerably the financial resources available for financing development expenditures and that as a result the Fifth Plan had undergone major revisions. The mission inquired about the general objectives of the revised Plan and the nature of the revisions made in the Plan. The Iranian representatives responded that the increase in crude petroleum prices were announced just after the earlier draft of the Fifth Plan had received Parliamentary approval, and it soon became evident that the increase in the availability of financial resources required a major revision of the Fifth Plan. Initially there were two schools of thought in Iran as to what revisions should be made. Most ministries wished to maximize the rate of development expenditures given the expanded availability of foreign exchange. On the other hand, the Plan Organization presented for consideration a set of alternative development expenditure targets along with assessments of the impact each would have upon domestic price stability and of the seriousness of the bottlenecks implied by each target level of expenditure. During the intragovernmental discussions which ensued, the reality of short-run limited absorptive capacity was perceived, and it was decided to scale down the requests of the ministries for investment funds and maintain development expenditures at a level more in line with domestic capabilities. The objective of the Plan was to achieve in Iran the highest rate of economic growth consistent with relative domestic stability. Specific criteria were established to determine which sectors of the economy would receive priority in the allocation of investment funds. Firstly, Iran's comparative advantage was considered, and as a result the petroleum and petrochemical sectors were assigned high priority. Secondly, it was clear that considerable investments were required to overcome the anticipated bottlenecks. Therefore, the ports and transportion system, the power sector (including production of natural gas) and the production of steel and construction materials were given special consideration. Thirdly, the agriculture sector was selected for special emphasis since industrial expansion required greater agricultural inputs and expanded production of foodstuffs would be needed to meet the increased demand for food engendered by rising incomes and high income elasticities.

The mission inquired about the nature of the bottlenecks which might constrain the rate of disbursement of development expenditures and project implementation and the measures undertaken to alleviate the bottlenecks. The Iranian representatives responded that in revising the Plan, the Plan Organization had identified several probable bottlenecks. Skilled manpower was singled out as a major limiting factor. The manpower gap was estimated at about 700,000 over the Plan period. Steps were being taken to try to overcome this constraint, which included better utilization of existing manpower resources, employment of foreign skilled labor both as actual participants in the labor force and for training Iranian personnel, and contracting out some projects to foreign firms who would supply their own labor. Additionally, since the greatest increase in the demand for labor was coming from the private sector, the Government was offering financial inducements to that sector to expand or organize labor training programs. The increased demand from the private sector for administrative talent was also manifest in a net outflow of experienced administrators from government service. Furthermore, shortages in certain categories of labor were already reflected in rising wage levels.

The Iranian representatives remarked that the ports and inland transportation bottlenecks had been identified, and the Plan Organization was attempting to quantify the physical capacity of the ports and transportation system as well as the demand that would be placed upon these facilities at alternative target levels of expenditure. The major problem which confronted the planners in this area was the time lag implicit in new undertakings in port and transportation infrastructure. New port facilities scheduled for construction during the Plan would not be operational until the end of the Plan period. In the interim, stratagems were introduced to increase the capacity of existing port facilities, such as redefining cargoes and employing new techniques of handling goods. It was estimated that with techniques formerly used the port system could process 4-5 million tons per year, but now under emergency regulations and the new techniques capacity had been expanded to 10-11 million tons per year. By the end of the Plan period, with the addition of new facilities, it was anticipated that port capacity would expand to 17-18 million tons per year. This was the port capacity required to achieve the minimum expenditure target under the Plan. Among other bottlenecks of concern to the Plan Organization were the inadequate domestic production levels of some goods, such as agricultural inputs for industry and construction material, as well as the difficulties of coordination and administration in project implementation.

The mission observed that in the revised Plan the industrial sector, which included manufacturing, mining, petroleum, gas, and power, appeared to receive considerable preference in the allocation of funds for fixed investment relative to the agricultural sector. The Iranian representatives responded that although the incremental allocations to the industrial sectors had been large, the revised allocations for fixed investment in agriculture were also sizable. The Plan Organization recognized the physical constraints confronting increased production from agriculture, particularly the supply of water, and had allocated at this juncture all the investment funds which that sector could absorb. Estimates of possible expansion in the agricultural sector varied widely, e.g., estimates for total irrigable land varied between 6 and 10 million hectares under existing technology. Iran intended to develop its agricultural sector to the greatest degree possible and sought to meet a large proportion of the demand for agricultural products from domestic resources. Nevertheless, it was unlikely that selfsufficiency in food would be achieved in the future, and to some extent Iran was expected to continue to rely on imported food to meet domestic demand.

The mission observed that a major stated objective of the Plan was to raise the standard of living and inquired as to the means employed to achieve this objective. The Iranian representatives responded that new social programs to be introduced during the Fifth Plan period included free primary education, a nationwide preventive health program as well as increased subsidies for basic foodstuffs. Each of these programs would have a considerable impact upon expenditures over the Plan period, but the magnitude of the impact could not yet be accurately gauged. The plans for free primary education, for example, were not yet finalized, while the cost of the expanded food subsidy program depended largely upon future movements in international prices.

The mission commented that given the existing bottlenecks too high a level of domestic expenditure would result in increasing domestic prices sharply, and thereby reduce the real value of fixed investments. The Iranian representatives agreed that rising domestic prices would increase the investment bill in financial terms for a given set of projects. Nevertheless, the Government was willing to pay this price in order to take the opportunity for accelerated development which had been offered by the increase in oil revenues. They believed that sufficient domestic production capacity should be established in certain major areas and the longer the expansion of these basic industrial sectors was postponed the more costly their development would become and the more difficult it would be to obtain the requisite imports for their establishment.

The mission observed that supply constraints in the ports and the transportation system brought into question the accuracy of the balance of payments projections made for the Plan period, particularly the import projections, as well as the accuracy of the projections for government expenditures. The Iranian representatives responded that it was difficult at this time to determine the trend of world prices over the Plan period and thus the magnitude of foreign exchange expenditures for the projects proposed in the annual programs. While financial allocations might be on the high side, it should be remembered that the availability of financial resources does not constitute a constraint on development at the present time in Iran.

The mission observed that the national income accounts for 1973/74 had shown a 34 per cent increase in constant gross national income, while the Fifth Plan postulated a 26 per cent annual average growth rate in gross domestic product. The mission inquired about the accuracy of these published growth rates and the estimation procedures employed. The Iranian representatives stated that a terms of trade adjustment had been employed to estimate gross national income in the 1973/74 national accounts and that terms of trade adjustments had also been applied to oil sector constant value added estimates for the Fifth Plan.

INTERNATIONAL MONETARY FUND

Iran: 1974 Article XIV Consultation

Minutes of Meeting No. 2

November 17, 1974

Tehran

Government finances

1. Institutional changes

The Iranian representatives described the institutional changes that came into effect in 1974/75. The former Ministry of Economy was dissolved and its functions were divided into three ministries: the Ministry of Industry and Mines, the Ministry of Commerce, and the Ministry of Economic Affairs and Finance. The Ministry of Industry and Mines was now responsible for general supervision of industrial and mining activities including industrial licensing and mine project planning and development. The Ministry of Commerce was now responsible for commercial and trade policy. The Ministry of Economic Affairs and Finance retained all functions formerly assigned to the Ministry of Finance except for oil policy and was now, in addition, responsible for coordination of overall economic and fiscal policy under the High Economic Council. The Ministry continued to be responsible for the administration of government revenue and expenditure policies (excluding however, the budgeting process which remained under the Plan and Budget Organization) and for international economic affairs including the analysis and coordination of government foreign investments and loans. The Ministry had been organized into customs, taxation, treasury, international relations and research departments and an affiliated Organization for Foreign Investments and Economic and Technical Assistance which was supervised by a committee comprised of the Ministers of Economic Affairs and Finance and of Foreign Affairs and the Minister of State and Director of the Plan and Budget Organization.

The mission noted that the new arrangements continued the rationalization of responsibilities for government finances which was begun in 1973/74.

2. Fiscal developments in 1973/74

The data provided by the Iranian representatives indicated that the outturn in the Central Government's finances had been greatly affected by developments in oil revenues. Oil revenues increased by 76 per cent to Rls 311 billion and exceeded budget estimates by Rls 85 billion. Non-oil revenues rose by 23 per cent to Rls 154 billion, current expenditures by 41 per cent to Rls 317 billion, and fixed capital expenditures by 22 per cent to Rls 161 billion. While non-oil revenues and current expenditures somewhat exceeded budget estimates, there was a slight shortfall in fixed capital expenditures. The Iranian authorities noted that the rise in current expenditures was largely the result of higher prices for domestic and imported goods and services. The 32 per cent growth in tax revenues was primarily the result of growth in the economy.

Summarizing the overall fiscal outturn for 1973/74 the mission noted that the additional oil revenues had reduced the original estimate of the deficit in the budgetary accounts by about Rls 90 billion to Rls 19 billion. Net domestic financing from the banking system, at Rls 13 billion, was lower than in 1972/73, while there had been a small net repayment of foreign borrowing as a result of lower utilizations. The mission commented, however, that the practice of including in preliminary actual expenditure data all disbursements from the Treasury, including those which were only transfers to deposit accounts of other government and public sector agencies, resulted in an overstatement of cash expenditures. As a consequence the public sector's position, as reflected in the monetary accounts, indicated a small surplus. In addition, this reflected differences in the definition of Government between budgetary and monetary accounts, and the mission urged that efforts be undertaken to institute appropriate accounting procedures. It further noted that the discrepancy between monetary and budgetary accounts for preliminary actual data was likely to grow larger in periods of rapidly rising revenues and expenditures such as 1974/75. However, the discrepancy should not exist between monetary and budget accounts for actual data as reported in the budget liquidation bill.

3. The revised budget for 1974/75

In reviewing the revised estimates for 1974/75, the Iranian representatives cautioned that the estimates were not yet final.1/ Oil revenues were projected to increase more than fourfold to Rls 1,350 billion and non-oil revenues by 14 per cent to Rls 175 billion. Current expenditures were budgeted to increase by 153 per cent to Rls 801 billion and fixed capital expenditures by 166 per cent to Rls 428 billion. The estimates projected a surplus of Rls 296 billion which was expected to be absorbed by foreign loans and investments (Rls 244 billion) and net foreign loan repayments (Rls 57 billion). Net domestic borrowing was projected to be Rls 5 billion.

1/ Subsequent to the consultation discussions, the revised budget estimates as submitted to the Majlis were provided to the mission by the Plan and Budget Organization; these estimates are used in the text of the minutes.

The mission expressed doubt as to whether actual cash disbursements would reach the levels budgeted for current and fixed capital expenditures. The Iranian authorities expected that, based on disbursements during the first seven months of the fiscal year, the current expenditures would approximately be met. They expected, however, that fixed capital expenditures would reach only about Rls 390 billion as a result of delays in project implementation due to shortages of raw materials and skilled labor. They further noted that some expenditures would represent only disbursements from the Treasury and that deposits of nonbudgetary agencies might be expected to rise.

The mission inquired into the foreign exchange component of government expenditures. The Iranian authorities estimated that at least 40 per cent of total expenditures in 1974/75 would represent foreign exchange disbursements, even after allowing for possible shortfalls in expenditures. They noted that this contrasted with a foreign exchange component of about 30 per cent in 1973/74 and earlier years. They expected that the foreign component of expenditures would be fully disbursed, and noted that government import payments were expected to more than double.

The mission inquired whether the revised budget estimates included the effects of programs designed to offset the rise in the cost of living by increasing real disposable incomes. The Iranian authorities said that both expenditure and tax measures of this nature were included. The Government, through various government-owned companies and organizations, was undertaking to subsidize foodstuffs, including wheat, sugar, meat, and rice, by purchasing commodities at market prices and reselling to the private sector at lower prices. Although the exact budget allocation would vary depending upon the difference between commodity purchase and sale prices, the operation would contribute to higher current expenditures. The Iranian authorities agreed to provide an estimate of the amount of the subsidy included in the budget.

The Iranian authorities commented that the tax measures taken to increase after-tax income included a reduction in payroll tax rates for lower income brackets and an increase in the exemption from Rls 6,000 per month to Rls 12,000 per month. For employees of government and government-affiliated agencies, the reduction in tax rates was greater, and the exemption was raised to Rls 24,000 per month. The relative increase in civil service after-tax incomes was also aimed at somewhat offsetting competition from the private sector in the labor market. The Iranian authorities also noted that as a counterinflationary measure the import registration fee was lowered from 5.5 per cent to 1 per cent and commercial benefit taxes were eliminated on foodstuffs and were lowered on a broad range of intermediate goods used as industrial inputs. The reduction in various taxes on imports was expected to result in a decline in receipts from customs revenues despite the large increase expected in imports. They noted also that a 15 per cent surtax was imposed on corporate income tax bills as a counterinflationary measure to absorb private liquidity, but not all the revenues from this measure would be received in 1974/75.

4. The 1975/76 budget estimates

In reviewing the proposed budget for 1975/76 the mission noted that the growth in oil revenues was projected to slow down substantially. Current expenditures were projected to increase by about 27 per cent and fixed capital expenditures by 21 per cent; the projected surplus was about Rls 218 billion. Net foreign investments and lending were projected to fall from Rls 244 billion to Rls 177 billion.

The mission inquired as to the reasons for the projected large increase in non-oil revenues from Rls 175 billion to Rls 270 billion. The Iranian authorities noted that additional tax changes were expected in 1975/76. A comprehensive review of the tax system was being conducted and future tax changes would be formulated to expand the tax base with the long-term objective of supporting continued growth in government budgetary operations after oil revenues stabilize in future years. In order to expand the taxpayer population and to increase the progressivity of the tax system, methods were being studied to reduce taxes on lower income earners which were to be offset by higher taxes on high income earners. The review was not restricted to income taxes. The Government also plans to introduce measures to improve tax administration. The Iranian authorities also cautioned that the expected structural changes in the tax system meant that the estimate of non-oil tax revenues was tentative. They noted that large increases in non-oil, nontax revenues, especially profits of government-owned enterprises, were expected. Furthermore, the proceeds of the 15 per cent corporate income tax surcharge imposed in 1974/75 were reflected in the estimates for 1975/76.

The mission inquired as to whether there would be an acceleration of disbursements of foreign loans and investments in 1975/76. The Iranian authorities noted that disbursements were not expected to exceed Rls 177 billion unless budgeted expenditure levels were not achieved. They commented, however, that commitments for foreign investments and loans totaling US$7.8 billion to date would be met but the actual disbursement per year could not be accurately estimated. The authorities stated that new commitments were now being undertaken only with careful consideration of available resources.

The mission noted that the 1974/75 and 1975/76 budget estimates indicated that government expenditures were projected to increase rapidly and inquired if a resource shortage would be encountered which would be reflected in inflationary pressures. The Iranian authorities stated that to some extent the rapid expenditure growth reflected a higher import component and increased import prices. In the future the indexing of oil revenues would ensure the maintenance of their value in real terms, and their growth in money terms would constitute an offset to a rise in expenditures resulting from inflation.

5. The Fund's government finance statistics project

The mission noted that work was initiated on the Fund's government finance statistics project during this visit and thanked the Iranian authorities for their interest and cooperation. It further stated that much work remained to be done, especially on economic classification of expenditures, financing and debt. Finally the mission hoped that an Iranian representative would attend the planned Nairobi seminar on the project.

The Iranian representatives made some comments on the balance of payments estimates for 1974/75. They felt that overall payments surplus would be considerably less than the US$10 billion envisaged by staff estimates. Asked if the total import figure included advanced import payments, which should be normally included in the net short-term capital movement, the Iranian representatives agreed that their import estimates included advanced payments of fairly large magnitude, especially for public sector imports. For 1975/76 the Iranian representatives envisaged a balance of payments surplus of approximately US$4.6 billion, compared with a staff estimate of US$6.3 billion.

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INTERNATIONAL MONETARY FUND

Iran: 1974 Article XIV Consultation

Minutes of Meeting No. 3

November 18, 1974

Tehran

Commercial policy

The mission observed that a substantial reduction in import duties, commercial benefit taxes (CBTs), and quantitative restrictions were recently implemented as incorporated in the Import-Export Regulations for 1974/75. The Iranian representatives stated that during 1974/75, the following measures were implemented: (1) the import registration fee was reduced from 5.5 per cent to 1 per cent; (2) commercial benefit taxes were either eliminated or reduced on a wide range of goods (294 items, including biscuits, chocolates, tea, wool, chemical products, and agricultural machinery) and customs duties on many goods were reduced; (3) some items on the "unauthorized" list were shifted to the "authorized" list; while some of these items are subject to the prior approval of the Ministry of Commerce, it was decided that no prior approval would be required for other items, including macaroni, refrigerators, radios and television receivers; (4) the import of some items which previously required the approval of the Ministry of Commerce was to be allowed without approval; these included iron, steel sheets, yarn, and most food items; (5) the rate of import deposit was reduced to a flat 15 per cent (previously 100 per cent, 40 per cent or 15 per cent) and in addition most food items became exempt from the import deposit requirement. The Iranian representatives explained that these reductions in import taxation and the lifting of the quantitative restrictions had been aimed at increasing supplies in the market especially for food and raw materials.

Asked how the Ministry of Commerce could make sure that reductions in import taxation would be passed on to consumers, the Iranian representatives replied that the Price Control Center was keeping track of price movements at all levels, and each importer or manufacturer was required to request permission to raise his prices. The impact of import cost reductions was carefully calculated by the Price Control Center before authorizing price increases. Since the commercial benefit taxes on many chemical products were substantially reduced at the beginning of this year, the Price Control Center would not normally permit at present price increases for chemical products. Manufacturers or importers are free to raise prices if they consider that their price increases are justified. However, legal consequences would ensue if the Price Control Center judged otherwise.

In response to the mission's inquiry as to how the Ministry of Commerce determined the quantity of goods to be permitted under its licensing authority, the Iranian representatives stated that the Ministry of Commerce investigated the relevant facts such as the level of total consumption, total domestic production capacity, price movements, and domestic manufacturers' delivery time for individual goods before deciding the amounts of imports to be permitted.

The mission asked about the reasons for Iran's maintaining quantitative restrictions on some import items instead of appropriate cost restrictions. The Iranian representatives stated that in some cases using cost restrictions alone is not sufficient to prevent excessive importation. Because of a recessionary tendency in some of the industrialized countries, there was a threat that exporters from these countries would attempt excessive penetration into the Iranian market. The Iranian representatives stated that in the past two months they had begun to find some import price reductions in textiles, automobiles, household appliances, petrochemical products and iron and steel, while import prices of foodstuffs, sugar, wheat, and butter were still going up. They said that for some items substantial import price declines had taken place, for example, synthetic textiles. However, the Iranian representatives said that it was too early to determine whether dumping was occurring.

Turning to the export promotion policy, the Iranian representatives stated that a sharp increase in domestic demand had narrowed the scope for increasing both traditional exports as well as exports of new industrial products. Exports of some foodstuffs had been forbidden by the end of 1973 to secure adequate domestic supply. The export of vegetable oil was banned, for example, because the Government was subsidising that item to secure a stable domestic price level. The Iranian representatives continued that the Government was not contemplating any additional export promotion schemes at this time but was continuing the programs previously in effect.

On bilateral payments agreements, the Iranian representatives confirmed that three new payments agreements (with the People's Republic of China, North Korea and Eastern Germany) were concluded and came into effect since the last consultation discussions. The Iranian representatives explained that under the new payments agreements the rial was used as the currency of denomination of balances; otherwise the terms of these agreements were mostly the same as those of other bilateral agreements. They stated that Iran needed to maintain and expand bilateral payments arrangements in order to secure additional export markets, especially for industrial products. Asked if the special trade and payments arrangements between the Foreign Transactions Company and the State Trading Corporation of Pakistan had been terminated, the Iranian representatives stated that the arrangement existed only for clearing small amounts of remaining balances, which would be settled within a few months. The mission pointed out that the Fund had requested that Romania, which was the only Fund member with which Iran had a bilateral payments agreement, terminate its remaining payments agreements and expressed a hope that Iran would terminate its arrangement with Romania as soon as practicable. The Iranian representatives stated that Iran's trading relations with Romania were guided by the fact that the trade and payments arrangement existed before Romania became a Fund member and it would in practice be difficult to cancel it in a short time. The Iranian representatives stated that there had been no changes in the RCD clearing arrangements with Pakistan and Turkey.

The mission drew the attention of the Iranian authorities to the Managing Director's letter to Fund members inviting them to subscribe to the "Declaration on Trade Measures". The mission pointed out that the pledge would not become operative until members having 65 per cent of the total voting power had subscribed to it and urged prompt action by the Iranian authorities. The Iranian representatives stated that they would consider the matter and would respond to the Fund as soon as a final decision was made.

In concluding the discussion the mission stated that Iran had made commendable progress in liberalizing trade restrictions. The mission was particularly interested in Iran's import liberalization measures as a means of adjusting its external payments position and hoped that further progress would continue for the benefit of both Iran and the international community.

INTERNATIONAL MONETARY FUND

Iran: 1974 Article XIV Consultation

Minutes of Meeting No. 4

November 18-19, 1974

Tehran

Balance of payments developments and policies

1. Recent balance of payments developments

The Iranian representatives stated that several measures had been implemented in recent months which would affect the balance of payments position of the current year (1974/75). These included the virtual elimination of the import registration fee, the sharp reduction in the import deposit requirements and in CBTs, some lowering of import duties, relaxation of quantitative import restrictions, freeing the exchange system and sharply increasing official loans and investments abroad. Furthermore, the Central Bank had encouraged the private sector to finance its imports locally rather than abroad and in some cases the bank had encouraged the accelerated repayment of suppliers' credit. This policy was well adhered to when interest rates abroad had been high compared with rates in Iran. However, as interest rates were beginning to decline abroad, a reversal of this trend might occur and this was causing some concern to the Central Bank, especially as some major firms could borrow externally without guarantee by local banks. In order to discourage the local banks from borrowing abroad, the Central Bank imposed a 15 per cent interest free special deposit requirement on commercial banks' net foreign liabilities.

Turning to the estimates of the exchange receipts and payments for the current year, the Iranian representatives stated that the overall surplus was likely to approximate US$7 billion compared with US$1 billion in the previous year (see attached table). The sharp increase in the surplus would reflect a US$15 billion increase in net receipts from the oil sector partially offset by a US$3 billion increase in net payments on the current account and by the reversal in the official capital account from a net inflow of US$1 billion in 1973/74 to an estimated net outflow of US$5 billion in the current year. These outflows included advance import payments, mainly by the public sector, of approximately US$0.8 billion. The mission thought that the estimated import level for 1974/75, particularly on private imports, appeared too high because of the various constraints in the port and inland transport facilities as frequently mentioned by the Iranian authorities. Furthermore, the price factor might not be as high as implied in the estimates, as prices of certain raw materials and intermediate goods had declined in the past few months as recessionary tendencies began to spread among some major exporting countries. The Iranian representatives emphasized the efforts to expand the effectiveness of port facilities rapidly this year. They mentioned that import channels were not confined to coastal ports as a considerable volume of imports had been coming in through northwestern or eastern borders by overland transportation. They mentioned also the factor noted above concerning domestic financing of imports which tended to increase import payments in the current year. With regard to the tendency of some prices to decline, the Iranian representatives said that import prices of capital goods, which constituted an important portion of total imports, had continued to rise, and even if some softening in prices of certain intermediate goods should occur this would not affect the import bill significantly until 1975/76. The Iranian representatives were aware that the margin of error would be large, especially as import registration in the previous six weeks had been somewhat less than what they had expected. However, on an overall basis, the surge in imports reflected in the estimates was essentially based on the strength of the domestic import demand.

Another comment by the mission was that the estimate of net service payments, which doubles to US$0.8 billion in 1974/75, appeared to be rather high, because interest income receipts were expected to increase sharply due to increasing exchange reserves while interest payments were estimated to decline due to prepayment of outstanding loans. While the Iranian representatives agreed that receipts in the services account would increase for the reasons noted by the mission, the expected large deterioration in the net balance in the services account would result from sharply higher payments for the foreign services required in implementation of development projects and other economic activities, as well as increased payments for tourism abroad.

Turning to the capital account, the Iranian representatives estimated that government loans and investments would amount to US$3.2 billion and repayment and prepayment of loans were estimated at US$1.4 billion.

2. <u>Exchange receipts and payments forecast for 1975/76</u>

The very tentative forecast for 1975/76 indicated oil revenues of US$21.5 billion, and substantial increases in payments on the current and the capital accounts. The Iranian representatives explained that while the estimation of oil receipts represented a conjecture which depended on a number of unclear elements, including the effects of increased oil prices on the level of demand and possible changes in average take per barrel, a 5 per cent increase in oil revenues would not be unreasonable unless major unforeseen developments took place. Import payments for the next year were expected to continue to grow at a steep rate, though slower than the growth rate estimated for the current year. Substantial net outflows on the official capital account were also to be expected. The net outcome of these factors was expected to be a reduction in the overall payments surplus to about US$4-4.5 billion.

The mission noted that the Iranian authorities were making rapid progress in their efforts to affect adjustments in their external accounts which was highly desirable from the point of view of the international community.

3. The exchange system

In January 1974 the Central Bank authorized a noncommercial (or free rate) market alongside the existing official commercial market. Foreign exchange proceeds received by the public sector (mainly oil revenues) and import payments were to be effected at the official rate. All other transactions were permitted to take place at the free rate. Export receipts and authorized invisible payments and capital transfers were permitted to be effected in either market. Other invisible payments in excess of authorized amounts could be made through the noncommercial market. This meant that the remaining exchange restrictions on current international payments were effectively eliminated as customers were permitted unlimited access to the noncommercial market even for capital transfers. At the start of the new exchange system the free rate of rials for U.S. dollars (the intervention currency) was depreciated by about 1 per cent relative to the official rate. Over a period of time the free rate moved closer to the official rate, and since June the rate quotations of rials for the U.S. dollar in both markets had been identical. Except during a brief period immediately after the introduction of this exchange system, the Central Bank had not provided any foreign exchange to the free market, nor purchased from it. Total commercial bank purchases of foreign exchange through the free market in the January-October period was estimated at US$980 million and sales at US$740 million. The Iranian representatives stated that through the introduction of these exchange arrangements the authorities hoped to create an international money market in Tehran to be supplemented by additional measures that might be required.

The mission, noting with satisfaction that Iran had effectively eliminated all remaining restrictions on current international payments as well as capital transfers, requested an explanation of the Iranian authorities' policy with regard to management of the noncommercial rate. The Iranian representatives stated that the structure of the two markets would ensure that the rates would not deviate from each other. Furthermore, it was the intention of the authorities to quote the markets in a manner that would result in the observance of the wider margins and the 2 per cent spread between buying and selling rates. This policy would apply under normal circumstances, but the Iranian authorities could not rule out a possibility that two rates might deviate in certain exceptional circumstances, such as when a sudden and large inflow or outflow of capital occurred. The authorities would then have to consider what measures would be appropriate and necessary. The mission noted that rial exchange rates for the U.S. dollar (the intervention currency) in both commercial and noncommercial markets had so far remained within the wider margin limits of Rls 69.7086 per U.S. dollar selling and Rls 66.6408 per U.S. dollar buying; and the spread between the official buying rate for the U.S. dollar (Rls 67.50) and the noncommercial selling rate for the U.S. dollar as well as the spread between the official selling rate for the U.S. dollar (Rls 67.75) and noncommercial buying rate for the U.S. dollar had so far remained within 2 per cent. The mission stated that the Iranian authorities had an obligation to notify the Fund and seek its approval in case exchange rates should move beyond the prescribed margin and/or spread.

In September 1974 the commercial and specialized banks authorized to deal in foreign exchange were permitted to import and export gold and silver and to sell these metals to any person in Iran; gold imports had to be in the form of bullion of at least 995/1000 fine. Previously imports of nonmonetary gold had been made only by Bank Melli Iran and exports had been prohibited. The Iranian representatives stated that some commercial banks were not familiar with transactions in gold and only a few banks other than Bank Melli were participating in this market. The Central Bank was hoping that the market for gold would develop in an organized manner and was requiring authorized commercial banks to post daily their sales and purchase prices.

In October 1974 the Central Bank authorized export contracts denominated in Iranian rials. The Iranian representatives commented that by authorizing exchange contracts denominated in rials exporters were expected to be able to eliminate exchange risks inherent to U.S. dollar denominated contracts. Asked if exporters were taking advantage of the new measure, the Iranian representatives said that rial denominated contracts were now confined to exports to the Persian Gulf area, though many inquiries were coming to the Bank from exporters.

4. Reserves management policy

Asked if the Central Bank had made any institutional changes regarding the management of external reserves since the level of reserves had risen sharply in recent months, the Iranian representatives stated that there had been certain institutional changes. Reserves management policy was guided by considerations of safety and terms. Currently, external assets are not invested in instruments with maturity in excess of one year, although in some cases the Bank had indicated to borrowers that deposits or loans would be renewed. In some cases the Bank had requested a guarantee before placing funds. The Central Bank had also paid due attention to the geographical distribution of its assets. Asked if the Iranian authorities had encountered any problems in placing funds, the Iranian representatives responded that no major difficulties had arisen in this regard. Sometimes larger Euro-dollar banks applied lower interest rates when funds were placed in excess of certain amounts, but there was not much difficulty redirecting the portion considered excessive elsewhere.

Summary of Foreign Exchange Receipts and Payments

(In billions of U.S. dollars)

		1973/74	Estimate 1974/75	Forecast 1975/76
A.	Current account	0.48	12.10	10.30
	Net receipts from oil sector	5.16	20.40	21.50
	Exports	0.64	0.80	1.00
	Imports	-4.96	-8.30	-11.00
	Private	(-2.70)	(-4.50)	(-5.50)
	Public	(-2.26)	(-3.80)	(-5.50)
	Services and private transfers (net)	-0.36	-0.80	-1.20
B.	Nonmonetary official capital (net)	0.77	-4.90	-6.20
	Drawings	1.31	0.50	0.20
	Repayments and prepayments	-0.54	-1.40	-1.40
	Advance payments for imports	--	-0.80	-0.50
	Loans and investments	--	-3.20	-4.50
C.	Errors and omissions (net)	-0.20	--	--
D.	Balance of payments surplus	1.05	7.20	4.10

INTERNATIONAL MONETARY FUND

Iran: 1974 Article XIV Consultation

Minutes of Meeting No. 5

November 19, 1974

Tehran

Monetary and credit developments and policies

The mission inquired about recent institutional changes in the banking system and the Central Bank's policy toward the licensing of new banks. The Iranian representatives responded that during 1973/74 a new specialized bank, the Development and Investment Bank, had begun operations and the Agricultural Development Fund had been chartered as a specialized bank. In 1974/75 a seventh specialized bank, the Construction Bank, had been established by private interests mainly to help in the financing of large construction projects. As this bank would facilitate the implementation of an important facet of the Government's development and social policy, i.e., increasing the supply of housing, it would receive loans from the Plan Organization through the Ministry of Housing and Town Planning. The bank was expected to receive assistance from the Central Bank as well as a loan of Rls 3 billion from the Plan Organization, approximately matching the bank's own capital; the bank had already made construction loans totaling about Rls 400 million. Two new commercial banks had been established this year, the Industries Bank and the Dariush Bank, and authorization had been granted for the establishment of a third bank as a joint venture with the Chase Manhattan Bank of New York. The monetary authorities felt that at present Iran was sufficiently provided with commercial banking services, although there continued to be a need for development banking services in the provinces in order to assist regional development through the private sector.

The mission inquired whether, given the rapid pace of developments in the recent past, the monetary authorities had encountered any particular problems in supervising the banking system. The Iranian representatives responded that more than a year ago the Central Bank, invoking its powers granted in the new Banking Law, had taken over two poorly managed commercial banks, the Commercial Insurance Bank and the Asnaf Bank; the former had been closed and liquidated, and the latter remained in operation under the supervision of the Central Bank. The monetary authorities were continuing their efforts to expand their supervision of the commercial banking system. The Central Bank was reorganizing its bank supervision department and also had introduced measures restricting the amount of borrowing from the banks by their owners and by any single company or institution. In addition, since it was believed desirable to increase the capitalization of the banking system, it had been decreed in June 1974 that for each bank the sum of total credit outstanding, its other financial assets and undepreciated fixed assets could not exceed an amount equal to fifteen times the sum of paid-up capital and reserves. At the time this regulation was put into force only five banks were in a position which violated its provisions. Steps were immediately taken by all of these banks to rectify the situation by increasing their capital. While the monetary authorities believed that the banking system as a whole was sound, they still thought that it would be desirable to increase the banks' capitalization as they foresaw rapidly expanding banking activity in the near future. The minimum capital for a bank had been increased to Rls 1 billion, and the monetary authorities intended to take measures to double that amount.

The mission inquired about plans to establish regional development banks. The Iranian representatives responded that at present seven regional development banks were planned. This decision was in line with the objective of the Plan Organization to decentralize the development process and increase local participation. At present most specialized development banks were located in Tehran, a situation inconsistent with the Government's development strategy. The Industrial and Mining Development Bank, the Industrial Credit Bank, the Agricultural Development Bank, and Bank Melli have been commissioned to establish jointly these independent regional development banks in the provinces. Although the regional banks would be separate entities, it was anticipated that a joint service unit would be established in Tehran. The service unit would pass along to the appropriate specialized banks in Tehran requests for expertise and for investment participation if the regional banks found their financial resources inadequate to fund certain projects. Of the capital requirements for each regional bank, 30 per cent would be subscribed by the parent banking institutions and the remaining 70 per cent by local individuals. Therefore lending policies would be determined on a regional level and not in Tehran. The regional banks would concentrate their lending operations in three sectors, industry, agriculture, and construction, and would receive some financial assistance for development purposes from the Plan Organization.

The mission commented that during the last consultation concern was expressed over the possibility that in 1973/74 too rapid a rate of monetary expansion would occur despite a sharp decline in the balance of payments surplus. Because of developments in the oil sector, however, a large external surplus had materialized. On the other hand, although there was a substantial increase in credit to the private sector, the contractionary influence of the small public sector surplus and the considerable increase in the unclassified nonmonetary liabilities held down the growth of the net domestic assets and as a result the expansion in domestic liquidity was more or less in line with the needs of the economy. The total of money and quasi-money increased by 29 per cent while the real growth rate in the economy was about 14 per cent and prices had increased by about 13 per cent. The Iranian representatives agreed with the mission's analysis of monetary developments last year. They added that credit to the private sector had been controlled through quantitative ceilings imposed on each bank and through the regulation of their liquidity. The actual increase was somewhat larger than planned partly because the Bank, in order to increase the supply of imports and limit the upward pressure on prices, permitted (beginning September 1973) preferential credit facilities for importers. Import credits increased by 86 per cent during the year compared to an overall increase in credit to the private sector of 35 per cent.

The mission observed that its estimates of the likely monetary developments in 1974/75 appeared to suggest an acceleration in the rate of monetary expansion for the year as a whole and particularly for the second half. Data for the first six months evidenced an increase in domestic liquidity of 19 per cent compared to 10 per cent in the like period of the previous year. More importantly, the mission projections for the year pointed toward possibly a 50 per cent increase in the money supply given the projected size of the surplus in the public sector. The Iranian representatives responded that the mission's expectations were higher than those of the Central Bank. The increase in domestic liquidity was estimated at 43 per cent. In terms of absolute changes, money and quasi-money were projected to increase by Rls 220 billion. This increase would result from an increase of Rls 486 billion in net foreign assets and an absolute decrease of Rls 266 billion in net domestic assets. With regard to the latter estimate, private sector claims were expected to increase by Rls 160 billion, while the public sector surplus would increase by Rls 352 billion and other items would be contractionary by Rls 74 billion. The Iranian representatives stated that the Central Bank was attempting to restrain the rate of credit expansion to the private sector. It had been estimated that an increase of credit to that sector of about 40 per cent over the March 1974 level was required. This implied an increase of approximately Rls 200 billion, but due to the reduction in import deposits and the fact that the Government had taken over some economic functions normally performed by the private sector (e.g., direct government importation of some commodities, government purchases of sugar production, as well as government transportation of some imported commodities) it was believed that an increase of about Rls 160 billion would prove adequate. Therefore, the original target increase was lowered by Rls 40 billion at mid-year.

The mission observed that an increase of 43 per cent in domestic liquidity would lead to significant upward pressures on prices and identified the problem primarily as one of too rapid a rate of government expenditure. The mission commented that bottlenecks in the ports and transportation system were not likely to be relieved to any great extent during the balance of the year, and consequently it was probable that the accumulation of foreign assets would not be reduced by an accelerated rate of importation. Therefore, the rate of expansion in government expenditure would need to be slowed if excessive inflationary pressures were to be avoided. A rate of monetary expansion of at most 35 per cent would appear to be more consistent with the anticipated increase in real output and in prices.

The mission observed that the deposit interest rate structure and the rediscount rates had been moved up in September 1973 and that there was some evidence that bank loan rates had increased in the past year. The Iranian representatives responded that given the credit squeeze which had developed with the continued strong demand for credit, it was to be expected that interest rates would move upward. The prime loan rate from commercial banks had peaked at 12-14 per cent during the year but had subsequently eased to 10-12 per cent currently. The movement of interest rates during the past twelve months was still under study by the monetary authorities. The Iranian representatives expressed concern over the increasing differential between interest rates abroad and in Iran and the possibility that this spread might result in capital inflows into Iran. The appropriate monetary measures to control such an inflow were under consideration; one measure had already been implemented, i.e., the imposition of an interest free reserve requirement on banks' borrowings abroad. Another measure under consideration was the downward adjustment of the interest rate structure.

INTERNATIONAL MONETARY FUND

Iran: 1974 Article XIV Consultation

Minutes of Meeting No. 6

November 19, 1974

Tehran

Oil policy

This is a summary of a meeting with His Excellency Jamshid Amouzegar, the Minister of Interior, who handles international negotiations on petroleum for Iran.

The mission inquired about Iran's oil policy. The Minister explained that the Government of Iran looked upon oil as an exhaustible national asset which should be conserved. Low prices would result in wasteful consumption of petroleum products and early exhaustion of proven reserves. Consequently, in order to encourage investments in alternative sources of energy, the Iranian authorities believed that the price of oil should not be less than the cost of alternative sources of energy. The Minister observed that currently the estimated per barrel price of petroleum extracted from oil shale and tar sands or the cost of the energy equivalent extracted from coal and nuclear power was markedly higher than prices for Persian Gulf crude petroleum.

With respect to production levels, the Minister said Iran's foreign exchange requirements could be met by producing approximately 4 million barrels per day of crude petroleum. At present, Iranian production exceeded 6 million barrels per day because Iran was aware of the energy requirements of the industrial countries and did not desire to bring about hardships and disruption in their economies. The Government was cognizant of the close interdependency existent in the world economy and the probability that recession abroad would harm Iran's own development efforts. Iran was pursuing this production policy despite the fact that the surplus foreign exchange generated and invested abroad was in reality earning a negative rate of return due to the high rate of world inflation. If the inflation factor is taken into consideration, the price of crude petroleum had declined in real terms since January 1, 1974. This is indicated by the fact that while the rate of world inflation in 1974 was likely to average about 14 per cent, the market price of crude oil had increased by only approximately 5 per cent. These developments in relative prices had prompted the Iranian authorities to call for indexing the price of oil in relation to the market prices of a basket of commodities imported by developing countries. This proposal would be pursued and discussed with other members of OPEC and with members of the OECD. In this vein, the Minister asked if the IMF would be willing to assist in developing an appropriate index. The mission responded that the Research Department of the Fund would be alerted that such a request might be forthcoming. The Minister added that the Government of Iran would also propose revising the methodology currently employed by the international oil companies and OPEC to determine government revenue per barrel. It was felt that the present system employing differential posted prices, royalty and tax rates, balancing margins, the effect of participation shares and other such esoteric price-determining elements was becoming increasingly complex and unwieldy. It was believed that the present model of price determination resulted in an undisciplined market. A unitary price system should be introduced to establish the market price (f.o.b.) for crude petroleum with variations for qualities of crude petroleum and geographical location. The Government of Iran favored that such decisions should be made within the context of OPEC.

Asked whether the reopening of the Suez Canal would result in a fall in oil prices paid by consumers, the Minister stated that this was unlikely as the excess capacity in world tanker fleets had driven down the cost of transporting oil from the Persian Gulf to Mediterranean ports via the Cape route. Furthermore, it was likely that Egypt would be able to set transit charges for crude oil through the canal at a level that would equalize the transportation costs for both routes.

The mission inquired about the magnitude of foreign exchange receipts expected from the oil sector in 1974/75 and 1975/76. The Minister stated that for 1974/75 receipts from the oil sector on an accrual basis were expected to reach about US$21 billion and a little less than that on a cash basis. This estimate was higher than others for two reasons. Firstly, in early November the Consortium had agreed to make retroactive payments to Iran totaling approximately US$850 million. Also corporated in this recent settlement was Iran's decision to implement the OPEC sanctioned increase in royalty and tax rates; these would rise to 16.67 per cent and 65.75 per cent, respectively, effective October 1. The consequence of these adjustments would be to increase government revenue per barrel by about US$0.38 over the July 1, 1974 level. Secondly, a slight seasonal increase in production during the last quarter of 1974/75 was expected to occur. With respect to 1975/76 it was estimated that receipts from the oil sector would increase to about US$22-24 billion depending upon price developments. Production was expected to increase by 3-4 per cent.

The mission commented that its discussions with the Iranian authorities revealed the commendable role played by Iran in the international balance of payments adjustment process, through pursuing appropriate demand, trade and exchange policies in addition to its reserves management and investment and loan policies. The Minister remarked that the Government was continuing its program of investments abroad. Most recently Iran had embarked upon a program of investment in agricultural projects overseas in order to ensure that Iran's imported food requirements would be met in the future. For example, Iran had recently decided to proceed with a US$40 million agricultural investment project in Australia which would produce meat for export to Iran. Also Iran was willing to increase its delivery of natural gas to Indian Ocean countries in order that they might expand their own fertilizer production and concomitantly their agricultural output. In return Iran would expect to receive increased exports of foodstuffs from these countries. The Minister observed that although the Government was vigorously pursuing the development of the agricultural sector in Iran, it was unlikely that Iran would be selfsufficient in food in the future. Iran might be able to supply itself with 75 per cent of its food needs, but the residual would need to be imported. It was estimated that Iran's annual import bill for foodstuffs in the near future would be of considerable magnitude and could reach US$7 billion annually.

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INTERNATIONAL MONETARY FUND

Iran: 1974 Article XIV Consultation

Minutes of Meeting No. 7
(Final Meeting)

November 23, 1974

In concluding the consultation discussions, Mr. Gunter remarked that the mission had found quite a favorable situation in Iran and that there was a large measure of agreement between the mission and the Iranian representatives regarding the problem areas in the Iranian economy and the appropriate policies for ameliorating these difficulties. There was also a broad agreement among Iranian officials with respect to these matters.

Iran was experiencing a high rate of growth extending to all sectors of the economy. Price increases accelerated in 1973/74 despite considerable measures to cushion the impact of rising prices abroad on the domestic price level. A major factor in this policy, which was wise and could well be afforded by Iran at the present time, was the encouragement of the flow of goods and services from abroad to Iran. Of particular importance was the estimated reduction in the landed cost of imports by about 10-12 per cent as a result of various measures implemented in the recent past. This policy has been highly successful and exceeded the earlier expectations of the Fund staff. Mr. Gunter noted that the policies of the authorities were achieving a considerable balance of payments adjustment from the strong surplus position resulting from the sharp increase in the oil sector's foreign exchange earnings. The overall balance of payments surplus was expected to decline in 1975/76 and near balance might be expected a year or two later. The authorities' balance of payments policies, which were discussed in detail during the consultation discussions, were appropriate and helpful to the international community as a whole in the present circumstances. However, as indicated by the Iranian representatives, expanding the flow of goods and services from abroad to Iran was unavoidably limited by certain bottlenecks, mainly an acute shortage of skilled labor and capacity limitations in the port and in the inland transport system. The mission was informed of the measures which had been taken to ease the situation in the short-run. Furthermore, policies were being implemented which would increase the economy's absorptive capacity over the longer-run. The authorities were aware that the critical factor in this regard was the skilled manpower shortage as it affected the growth prospects of the economy.

Considering that the maximum possible was being done to increase the flow of goods and services from abroad, an undue increase in total domestic demand would result in pressures on domestic resources leading to price increases. With respect to the regulation of the level of domestic demand, the level of budgetary expenditures was the central consideration, especially as revenues derived from the export sector of the economy accounted for over 90 per cent of total government revenues. An excessive level of government expenditures, which under the existing circumstances could not be absorbed by a reduction in the balance of payments surplus, would result in a rate of expansion in domestic liquidity exceeding the genuine needs of the economy. The monetary accounts, as traditionally constructed, did not highlight this aspect clearly. These accounts would show the balance of payments surplus as the main expansionary factor with the build-up in public sector deposits being the principal contractionary influence. In fact, the Government's fiscal operations constituted the primary source of liquidity injection into the economy to the extent that total domestic expenditures (i.e., excluding direct expenditures in foreign exchange) exceeded the collection of non-oil revenues. With respect to the private sector, the increase in credit to that sector was usually more than offset by the net loss of foreign exchange arising from the balance of payments deficit of the private sector.

Adequate detailed data for recasting the monetary accounts along the lines indicated above were not available. However, the mission had made some rough calculations based on general assumptions in order to provide an illustrative example of these factors. These calculations showed that the expansion in money and quasi-money resulted entirely from the expansionary impact of the Government's fiscal operations. The impact of this factor was estimated to double in 1974/75 to over Rls 400 billion relative to its level in 1973/74. On the other hand, as the balance of payments deficit of the private sector was forecast to increase sharply while credit to that sector was projected to rise moderately, the net contractionary impact of that sector was estimated to treble. It would appear then that while policies pertaining to the expansion of credit to the private sector had been well conceived and appropriate, excessive monetary expansion could arise in 1974/75 reflecting a too high level of government net domestic expenditures. Therefore any adjustments that might be required would relate to the level of expenditures by the Government.

The Governor of the Central Bank thanked Mr. Gunter for his remarks, and he too was of the opinion that there had been a broad measure of agreement in these discussions. The Iranian authorities were aware of the new international situation and of the need for adjustment measures. A very high priority was being accorded to expanding the absorptive capacity of the economy with particular emphasis on the labor situation. The authorities were pressing on with the development program and effecting some redistribution of income. On the external side, the authorities were making a great effort to contribute to the international balance of payments adjustments process. Iran would not seek to accumulate foreign reserves excessively. The authorities had taken measures to stimulate import demand and to expand sharply net official capital outflows. The Governor remarked in this regard that the decrease in the landed cost of imports would be closer to 15 per cent if adequate consideration was taken into account of the substantial subsidization of imports. The Central Bank was undertaking a study to determine the impact of these subsidies.

Regarding the monetary accounts, the Governor said that the Central Bank would study the new presentation. At this point, however, he wished to note that to the indicated level of increase in credit to the private sector one should add Rls 40 billion which is equivalent to the release in liquidity resulting from the reduction in the prior import deposit. Regarding the appropriate level of monetary expansion in 1974/75, the authorities had this matter under constant review depending upon developments in the economy and in prices.

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BANK MARKAZI IRAN

(THE CENTRAL BANK OF IRAN)

GOVERNOR

TEHRAN

EB. 536

Mr. John W. Gunter,
Acting Director,
Middle Eastern Department,
International Monetary Fund,
Washington D.C. 20431,
U.S.A.

Dear Mr. Gunter,

I thank you for your letter of 9th October 1974, confirming the forthcoming consulation in Tehran.

In the meantime, I have got my colleagues at this end working on the necessary data and hope they will be ready when your mission arrives.

With best regards,

Yours Sincerely,

M. Yeganeh

Mohammed Yeganeh

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DIVISION

Office Memorandum

TO : The Acting Managing Director

DATE: October 22, 1974

FROM : John W. Gunter JWG

SUBJECT : Iran: Briefing Paper

Attached for your consideration and approval is the briefing paper for the 1974 Article XIV consultation discussions with Iran. This draft has been cleared with the appropriate departments.1/ I depart for Iran on November 11.

1/ Mr. Mookerjee (ETR), Mr. Beveridge (FAD), Ms. Lachman (LEG), Mr. Miller (Treasurer's), and Mr. John Smith (Research).

INTERNATIONAL MONETARY FUND

IRAN

Briefing Paper - 1974 Article XIV Consultation

Prepared by the Middle Eastern Department
and the Exchange and Trade Relations Department

WBD

Approved by John W. Gunter
and Subimal Mookerjee

October , 1974

I. Introduction

In accordance with established procedures, a staff mission composed of Messrs. John W. Gunter, Said H. Hitti and Henry E. Jakubiak of the Middle Eastern Department, Robert H. Floyd of the Fiscal Affairs Department and Yukio Iura of the Exchange and Trade Relations Department will hold the 1974 Article XIV consultation discussions in Tehran during the period November 16-23, 1974. Some members of the mission will arrive in advance to prepare for the discussions and to initiate preparatory work for the Fund's Government Finance Statistics program. It might be necessary for Mr. Floyd to stay in Tehran up to one week following the completion of the consultation discussions in order to carry on the work of the GFS project. The Executive Board discussed the 1973 Staff Report (SM/73/209 and Supplement 1) on November 5, 1973. Iran is listed among the group of countries scheduled for special consultation discussions in the autumn of 1974. These discussions will be held during the period scheduled for the Article XIV discussions.

II. Relations with the Fund

Iran is an original member of the Fund. The present quota is SDR 192 million. The Iranian rial was depreciated along with the U.S. dollar after August 15, 1971 and in September 1972 the par value of the rial was changed with Fund concurrence from Rls 75.75 per SDR to

Rls 82.2425 per SDR. In February 1973, Iran maintained this par value and the rial exchange rate in terms of the U.S. dollar became Rls 68.1747 per US$1. Fund operations are carried out and Fund holdings are valued on the basis of a representative rate for the Iranian rial. Iran opted for wider margins in October 1973.

Iran has had relatively few transactions with the Fund in recent years, and all purchases have been within the gold tranche. Iran's most recent transaction, a repurchase under Article V, Section 7(b) equivalent to SDR 28.74 million effected in January 1973, reduced the Fund's holdings of Iranian rials to the present level of 75 per cent of quota. The Fund has a borrowing agreement with Iran for the equivalent of SDR 580 million in order to finance purchases under the Oil Facility. As of September 30, 1974, the equivalent of SDR 115 million of this amount had been used.

Iran is a participant in the Special Drawing Account and has received a total of SDR 61.9 million. As of September 30, 1974, Iran had used SDR 40 million to obtain currency and SDR 1.9 million with the General Account. Under designation, Iran has provided currency totaling the equivalent of SDR 24.5 million. At present Iran's holdings of special drawing rights total SDR 44.5 million, equivalent to 72 per cent of net cumulative allocation. Iran is included in the current (October-January) designation plan for SDR 24 million.

III. Background

Iran experienced rapid and accelerating economic expansion during the Fourth Plan period, 1968/69-1972/73 (fiscal year ended March 20). The growth rate of real gross national product averaged 14.5 per cent in the last two years of the Plan. The leading growth sectors were oil, services and manufacturing, while the growth rate of the agricultural sector lagged considerably. Iran's exceptional growth performance in recent years can be attributed to high rates of national saving and domestic capital formation, facilitated by rising foreign exchange receipts from the oil sector and net capital inflows. Preliminary data for 1973/74 suggest an acceleration of the rate of economic expansion and this trend is expected to continue in 1974/75.

The petroleum sector has traditionally held a predominant position in the economy. Its status as a productive sector and a source of foreign exchange has been enhanced in recent years by expanded production and sharp increases in prices, particularly during the last half of 1973/74. During the four-year period ending 1974, petroleum production will have risen at an estimated annual rate of more than 16 per cent. The increase in petroleum prices, however, has been considerably more spectacular. The posted price for Iranian light crude petroleum has increased from US$1.79 per barrel in February 1971 to US$11.88 per barrel in January 1974. Consequently, the oil sector's net foreign exchange receipts are expected to increase from about SDR 2 billion in 1972/73 to an estimated SDR 17 billion in 1974/75.

Government finances have been influenced by the developments in the oil sector. Over the two-year period ended 1972/73, government development and current expenditures kept pace with the steep rise in revenues, and the budget continued in deficit, requiring resort to external financing and net domestic borrowing. The revised budget for 1973/74 was presented to Parliament in November 1973 and incorporated the revenue impact of the October 1973 increase in petroleum prices. Estimated revenues were revised upward by 16 per cent and estimated expenditures by 7 per cent. At the same time the budget estimates for 1974/75 were also presented. These estimates have been made obsolete by the sharp rise in oil prices in January 1974, and the consequent accelerated growth in oil revenues, and by the changes in direct and indirect taxes which have been introduced. Moreover, the Government has decided to expand development and defense expenditures, prepay some foreign loans, undertake a foreign investments and loans program, raise salaries, implement new expanded social programs (including free education and health services) and — subsidize certain basic food items.

The original draft of the Fifth Development Plan 1973/74-1977/78 has also been outmoded by the sudden change in the Government's financial position. As initially conceived, the Plan called for investment expenditures of Rls 2,460 billion. The revised Plan was expanded in August 1974 by nearly 90 per cent and now totals Rls 4,634 billion (US$68.5 billion), the public sector accounting for 66 per cent of planned investments. The growth rate of real GNP is targeted to average 26 per cent over the Plan period. The economic sectors which will receive primary emphasis are petroleum and petrochemicals, manufacturing, transportation and construction.

In 1972/73, the increase in oil revenues ______________________________ ______________________________ improved considerably the balance of payments position. Consequently, the Central Bank relaxed its restraints on credit to the private sector and claims on that sector increased by 31 per cent. This factor along with sharp increases in net foreign assets resulted in an expansion of domestic liquidity of 35 per cent compared with 26 per cent in the preceding year. Nevertheless, the price level remained relatively stable

By mid-1973/74, however, the monetary authorities became concerned over the accelerating rate of price increases. Therefore, in September 1973 the Central Bank took steps to limit the growth of credit to the private sector. Despite these restraints, credit to the private sector expanded by 35 per cent in 1973/74. The slowdown in the rate of growth of domestic liquidity to 29 per cent resulted mainly from the build-up of government deposits in the last quarter of the year.

Iran's balance of payments recorded surpluses in 1971/72 and 1972/73 totaling nearly SDR 950 million. Although net foreign exchange receipts from the oil sector increased sharply, there occurred a parallel upward movement in foreign exchange expenditures, and the current account remained in deficit. The external surpluses thus reflected mainly net official borrowing abroad. In 1973/74 the increase in oil prices had a dramatic impact upon the balance of payments position. Iran experienced a current account surplus for the first time in nearly a decade and since the capital account continued in surplus, the external payments surplus surged to SDR 887 million. The full financial impact of the increase in oil revenues on the balance of payments will be felt in 1974/75. Net receipts from the oil sector may reach about SDR 17 billion, and a current account surplus in the order of SDR 10 billion is expected to materialize. The Iranian authorities have already undertaken measures to limit the magnitude of the 1974/75 external surplus. Expanded imports have been encouraged through cost reductions.

Official borrowing abroad has been curtailed, the repayment of public external debt has been accelerated and Iran has entered into a number of trade, direct investment, and loan agreements which are expected to transfer considerable capital resources abroad during the current fiscal year. Nevertheless, a balance of payments surplus of about SDR 7-8 billion is anticipated.

With regard to the exchange system, the Central Bank authorized in January 1974, a free (or noncommercial) exchange rate for commercial banks. Previously, all exchange transactions by the Iranian commercial banks were carried on at official rates. The new regulations issued in January 1974 abolished the surrender requirements for foreign exchange receipts from nonoil exports, services and certain capital transactions, and permitted commercial banks to purchase foreign exchange from these sources and sell it for any purpose at the free market rate. Government exchange receipts, mainly oil revenues, continued to be sold to the Central Bank at official rates. The free exchange rate has not in fact deviated much from the official rate; in fact all buying and selling rates for the intervention currency (the U.S. dollar) remained within a spread of 2 per cent. During the first half of 1974, the exchange rate differentials narrowed, and by June the buying and selling rates for the U.S. dollar were identical in both markets. It was reported that in September the Central Bank lifted the remaining exchange restrictions and announced _de facto_ convertability of the rial. At the same time, the Central Bank removed existing restrictions on authorized banks' external transactions in gold and silver bullion. Iran, however, continued to avail itself of Article XIV status in the Fund.

While Iran has now a virtually free exchange system, the trade system remains protectionist to a substantial degree even though the new trade regulations for 1974/75 lowered or eliminated the commercial benefit tax on a wide range of commodities, lowered the import registration fee, and removed other trade restrictions for selected commodities. Iran has bilateral payments agreements with seven CMEA countries, North Korea and Mainland China. Some payments are also made over clearing accounts maintained with Turkey and Pakistan under the Regional Cooperation and Development agreement.

IV Topics for Discussion

The economic and financial situation in Iran has undergone a dramatic change since the last consultation discussions, mainly as a result of the sharp increase in oil revenues. The declared policy of the authorities is to utilize these vastly increased revenues with a minimum of delays. Consequently, a sharp increase in demand pressures is to be expected. A primary task of the mission will be to assess, to the extent possible, the implications of this posture for fiscal, development and monetary policies. In light of this assessment, the mission will discuss the specific policy / adjustments that might seem to be appropriate.

The mission will need to explore the attitude of the authorities with respect to a number of crucial factors. These include the level of oil production as it relates to / maintaining or increasing the price of oil and the measures taken to increase the absorptive capacity of the economy and overcome supply constraints. On the factual level, the mission will need to inform itself of the details of the changes in the 1974/75 budget and in the Five-Year Development Plan.

The growth in oil revenues, however, is of such a magnitude that, despite the planned expansion in expenditures, substantial balance of payments surpluses are unavoidable over the next several years. The mission will attempt to estimate the magnitude of the balance of payments surplus and discuss the policy implications.

The increased availability of foreign exchange has permitted the Government to introduce important changes in the exchange and trade systems. The mission will ascertain that the exchange market arrangements described above have been superceded by the _de facto_ convertibility of the rial at the official exchange rates. The mission will ascertain that all exchange restrictions on current payments have been abolished and if not, will look into the rationale for any restrictions that might still be in effect. Import restrictions remain highly protective despite the recent liberalizations undertaken to reduce pressures on the domestic price level. Given Iran's development objectives, it is likely that protective tariffs on many manufactured goods will remain in force. The mission will discuss this policy and its implications for economic progress and the efficient allocation of resources and will review the prospects for further import liberalization.

The Iranian authorities have had under consideration for some time a move to Article VIII. With the announced _de facto_ convertibility of the rial such a move seems appropriate assuming the authorities will eliminate all or most of the few remaining restrictions on current payments. The mission will investigate the degree of restrictiveness of the bilateral and regional payments arrangements maintained by Iran and urge the termination of the arrangements with Fund members as soon as practicable.

In the present international situation, Iran has followed reserve management and foreign lending policies designed to ameliorate balance of payments dislocations. The mission will attempt to gain as full a picture as possible of Iran's activities in these fields and will inquire about policy intentions for the future. Of particular importance will be Iran's attitude regarding further lending to the Fund to finance the oil facility in 1975 and possible use of Iranian rials held by the Fund in the Fund's transactions.

The Iranian authorities have given clear and strong indications that they wish to have a very large increase in their quota in the Fund. Should they raise this question, the mission will say that this issue is still under discussion by the Executive Board.

The mission will draw the attention of the authorities to the Managing Director's letter dated June 27, 1974 to Fund members inviting them to subscribe to the "Declaration on Trade Measures" contained in the C-XX communique of June 13, 1974 and to inform the Fund of their decision. While reiterating the voluntary nature of the Declaration, the mission will note that as the pledge will not become operative until members having 65 per cent of the total voting power of Fund members have accepted it, the Fund management encourages the authorities to subscribe to the Declaration as soon as possible. While Iran, as an oil surplus country, is not expected to escalate restrictions on trade and payments, its acceptance of the Declaration would be helpful in securing the required majority for the Declaration to become operative.

Office Memorandum

TO : Mr. Said H. Hitti

DATE: 10/18/74

FROM : W. A. Beveridge

SUBJECT : <u>Iran--Briefing Paper</u>

Aside from certain minor points which Mr. Floyd will convey to you regarding the briefing paper for the Article XIV consultation mission with Iran, I have one general point which I would like to mention.

On the whole, I feel the paper appropriately draws attention to the main areas which need to be discussed. As the paper points out, the two principal problems facing Iran are domestic inflation and the balance of payments adjustment. I believe it would be useful to indicate that Iran differs from some other oil exporting nations in several important aspects, such as a broader industrial base. This may mean that the exchange rate is a viable policy instrument for attacking the inflation and the balance of payments issues. I suggest, therefore, that the mission consider the possibility of including a passage in the briefing paper on use of the exchange rate. I might mention that it would be helpful to give the reader some further indication (possibly in the first paragraph under "Relations with the Fund") as to the value of the rial--in terms of SDRs--at present compared with an earlier benchmark, say, May 1970.

cc: Mr. Floyd

Mr. Gunter:
I told Mr. Beveridge that I will pass this on to you and that you will keep this in mind during the special consultation discussions. I said that they are not inclined to do this.
S.H.

OFFICIAL **OUTGOING MESSAGE** OFFICIAL

INTERNATIONAL MONETARY FUND
WASHINGTON D.C.

FOR PREPARING OFFICER

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SPECIAL INSTRUCTIONS

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OCT 18 1974
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To: Governor Yeganeh

MARKAZBANK

Teheran, Iran

Mission members arriving as follows: Jakubiak and Floyd, LH600 October 26 at 2240; Iura, IR716 November 5 at 2025; Miss Smart, AF160 November 5 at 2035; Hitti, SR 378 November 8 at 2359; and myself BA810 November 14 at 2205. Regards

Gunter
Interfund

Drafted by S.H. Hitti/bw

Department MED

Date Ocotber 18, 1974

AUTHORIZATION

Signature

JWGunter

Second Signature When Required

FOR CODE ROOM

Time Received 3:00 P.M.

Time Dispatched 3:57 P.M.

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Mr. Gunter

October 18, 1974

MEMORANDUM FOR FILES

Subject: Article XIV Consultation and GFS Missions to Iran

1. During the period October 23 to November 25, 1974, I shall be on a combined GFS and Article XIV consultation mission to Iran. I shall be accompanied during this period by Mr. Jakubiak (MED). We shall be joined later by other members of the consultation mission. Although most of the initial two weeks will be devoted to the GFS project, Mr. Hitti has indicated his desire that some of this time be devoted to preparation of fiscal data for the consultation discussions, but it is also expected that some of the final two weeks can be devoted to GFS work. If the situation indicates that significant additional progress can be made on the GFS project, and if the Iranian authorities are receptive, I shall recommend to Mr. Gunter that I remain in Teheran for up to one week after the above dates to continue GFS work.

2. The purpose of the mission will be to initiate work on the GFS project in Iran. In accordance with earlier arrangements with Mr. Majidi, Minister of State and Director of the Plan and Budget Organization, my principal contacts will be with the Plan and Budget Organization. I also expect that appropriate contacts with the Central Bank and the Ministry of Economic Affairs and Finance will be arranged by the Plan Organization, but owing to the recent government reorganization arrangements with the Ministry are uncertain. To assist the Plan Organization in its preparations, I have sent a set of questionnaires and have provided extra copies of the draft GFS Manual. It is hoped, but not expected, that some of the information requested in the questionnaires will be prepared in advance of the mission's arrival, so that only outstanding and problem areas can form a work agenda during the visit.

3. As reflected in the questionnaires, the initial efforts will concentrate on delineation of the government and public sectors in Iran. The Iranian budget is a complicated document which contains extensive data on various central government ministries and agencies, government companies and public enterprises, and a host of decentralized agencies. A large number of intragovernmental and intergovernmental transactions are included, and the system for classifying expenditures is not always obvious. However, no information on extrabudgetary expenditures which are believed to be large or on regional or local governments is included and little information is available on social security systems. The second stage of the work will be an investigation of the budget and accounting system of the central government particularly and, if available, of other levels of government and public enterprises. Finally, I shall attempt to derive the Fund's GFS formats from available data sources, principally the budget document, and information provided by the Iranian authorities. Although it is expected that data work may have to be restricted to the Central Government during this mission, some work may also be possible on the public enterprises. Preliminary information indicates that significant difficulties may be encountered in reconciling banking and budget data on deficit financing and government debt and in the

preparation of an economic classification of expenditures. It appears unlikely that any significant progress can be made on obtaining or classifying regional or local government data on this mission.

Robert H. Floyd

cc: Mr. Gunter
Mr. Hitti
Mr. Whitfield

October 9, 1974

Dear Governor Yeganeh:

As agreed with you during the recent Annual Meeting, we are proceeding with our plans for the 1974 Article XIV consultations with Iran being conducted during the period November 16-23. In addition, I should mention that Iran is included again in the list of countries for special consultations to provide background for the World Economic Survey, which is to be completed by the Fund staff in December. I am confident that the regular consultations discussions, plus perhaps a special meeting with you, will provide us with the necessary material required for the latter purpose.

Some members of the mission will arrive in Teheran in advance to prepare for the discussions and I will be cabling you later regarding the precise details of arrivals. In fact, two members of the mission will arrive on October 26 to initiate preparatory work for the discussions as well as for the Fund's project on Government Finance Statistics in which Iran is a participant. I am writing directly to Dr. Majidi regarding the latter aspect of the mission's work and attached please find a copy of that letter.

It would be helpful if you would kindly request the responsible departments to initiate the data collection process. For your convenience I am attaching a list of the information which will be needed. I very much appreciate your help in this matter and I am looking forward to seeing you in the near future.

With best wishes.

Sincerely yours,

John W. Gunter
Acting Director
Middle Eastern Department

Dr. M. Yeganeh
Governor
Bank Markazi Iran
Teheran, Iran

Attachments (2)

October 9, 1974

Dear Dr. Majidi:

During our discussion last April in Washington you indicated Iran's continuing interest in participating in the Fund's Government Finance Statistics project and it was agreed that the initial work on this project would be carried out at the time of the forthcoming Article XIV consultation discussions. Mr. Robert Floyd of the Fiscal Affairs Department and Mr. Henry Jakubiak of the Middle Eastern Department will arrive in Teheran on October 26 to initiate the preparatory work for the consultations as well as for this project. The consultation discussions are scheduled for the period November 16-23. Should there be a need, Mr. Floyd could stay in Teheran for a few days after the conclusion of the discussions.

The Government Finance Statistics project was discussed in a preliminary manner with Mr. Mejloumian during the recent Annual Meetings. I hope that, in addition to the persons assigned by you for work on this project, appropriate personnel from the Ministry of Economic Affairs and Finance will also be assigned to participate. As we discussed in April, I am enclosing a questionnaire which has been developed to assist your staff in their preparations. We hope that as much information as possible could be prepared in accordance with the draft Manual before the mission's arrival so that outstanding problem areas could be discussed with the mission's advance team.

I am looking forward to seeing you in Teheran in the near future.

With best wishes.

Sincerely yours,

John W. Gunter
Acting Director
Middle Eastern Department

Dr. Abdul Majid Majidi
Minister of State and Managing Director
Plan and Budget Organization
Teheran, Iran

Enclosure

cc: FAD
BUR