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INTERNATIONAL MONETARY FUND

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TO: Members of the Executive Board

FROM: The Secretary

SUBJECT: Survey of the Economy of Iran

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INTERNATIONAL MONETARY FUND

Research Department

This paper does not contain confidential information.

Survey of the Economy of Iran

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I. Population

No general census of the population of Iran has ever been undertaken. Estimates, based on the urban population, range from 15 to 18 million. Despite some concentration in the northwestern and western provinces, the country as a whole is sparsely populated, and the density per square mile has been variously estimated at between 20 and 25.[1] The standard of living of the population is extremely low, and illiteracy is prevalent. Although no vital statistics are published, the general death rate and the infant mortality rate are known to be very high, owing to the ravages of malaria and other endemic diseases.

It is estimated that about 1.8 million people live in the seven towns with a population exceeding 100,000, and that 2.3 million live in towns with a population of over 20,000. The unsettled state of the population is evidenced by the fact that the nomadic tribes total 3 million approximately. It has been estimated that 85 per cent of the active population derive their livelihood from agriculture and stock-raising, while 15 per cent are engaged in trade, industry and crafts. The wartime rise in the wages of construction workers has led to a marked movement away from agriculture and the crafts into road and railway building. With the cessation of military investment, unemployment among unskilled workers became rife.

The introduction of modern sanitation envisaged in the Government's new plan would result in an appreciable increase in numbers as the rate of fertility, in common with other Eastern countries, is high. Owing to the present underpopulation of Iran, such increase in numbers, even in the present state of development and technique, would raise productivity per head, while a more rational use of resources and the mechanization of agriculture and transport would release workers for other employment.

2. The Main Features of the Economy

Agriculture:

Of the total area of Iran (628,000 square miles) 30-35 per cent is arid desert. Forty per cent of the total area is potentially cultivable,

1/ This computation is, however, highly misleading owing to the existence of vast uninhabited areas, especially in the east.

but the area at present under crops does not exceed 10 per cent. This is attributable to (1) the inadequacy of irrigation over wide areas where mean annual precipitation is negligible, and where the rivers are salty; (2) extreme climatic conditions; (3) the mountainous character of the country; (4) the difficulties of transport and the inaccessibility of certain potentially fertile areas; and (5) scant population especially where the procurement of water for irrigation requires the digging of deep underground canals on the slopes of hills. The discrepancy between actual and potential production in agriculture has impressed the planning authorities, who devote the major part of the contemplated capital investment to irrigation, water conservation and flood control projects and the provision of storage facilities to reduce waste.

About 10 per cent of the arable land is state-owned, but large sales to small holders are under way through the state agricultural bank. Private ownership of land is highly concentrated, but the number of owner-farmers is small, and the predominant system of tenure is sharecropping. The insecurity of tenure and the various exactions of the landlords weigh heavily on the peasantry. Recent legislation, however, attempts to remedy the situation by raising the share of the peasant relatively to that of the landowner, increasing the number of small holders (10 hectares or less), and granting long-term credit at a moderate rate of interest to the newly created small holders.

Although Iran is, in the main, a cereal-producing country, agricultural production displays a certain variety owing to the differences in soil and climatic conditions between the various regions. Fertile lands are mainly in the northwest, the southwest and the extreme south. Productivity per acre and per man are low owing to ignorance, the persistence of primitive methods of agriculture, the use of antiquated implements, the dearth of chemical fertilizers, the ravages of sea locusts and other pests,[1/] soil erosion, and the traditional system of land tenure which hinders improvement and encourages "land mining".

Table I
Land Utilization and Agricultural Production

Year	Crop	Area (million acres)	Production (thousand tons)
1937-38	wheat	4.3	2000
1937-38	barley	1.6	750
1934-38	rice	.5	450
1935	cotton	.2	75
1934-38	grapes, raisins, oranges, dried fruit		550
1934-38	dates	?	100
1934	beet sugar		60
1939-43	pulses	.2	150

1/ Estimated at $30 million annually. Joint efforts by Middle Eastern countries are being made to combat the periodic locust invasions.

Table I gives a very rough idea of land utilization and agricultural production in various years.

Before the recent war, local production of wheat, barley and rice was adequate for the meagre standards of consumption of the population, and there was an export surplus of food grains amounting to 400,000 tons. Cotton was an important cash crop, but owing to its low quality, Iranian tobacco was not exported on any appreciable scale. The war brought about some change in the pattern of land utilization. Thus, until 1943, the area under cereals declined, and there was a fall in yields so that for the first time, it was found necessary to import food grains. Moreover, the area under cotton showed an appreciable decline. In 1942, wheat production fell by 40 per cent, barley by 20 per cent, and cotton by 35 per cent. Since 1943, cereal production has recovered but has not yet reached the prewar level. For humanitarian reasons, and in deference to the recommendations of the League of Nations, the cultivation of opium, except for medicinal use, has been gradually restricted; and the Government is trying to find a cash crop to compensate farmers for the loss of income from opium-growing. The development plan now under consideration envisages a rise of existing crop yields by 50 per cent, the extension of the area under cereals, long-staple cotton, fruits, sugar cane and tea, and the introduction of new crops such as soya beans and flax.

Forestry:

Iran has large forest resources especially in the north, and a beginning is being made with their conservation and scientific exploitation. Owing to the lack of transport facilities, only some varieties of gum and medicinal plants are at present exported. Timber is produced for local use, especially in the construction of sleepers for Iranian railways.

Animal Husbandry:

The animal population of Iran is large, and 15 per cent of total area is devoted to grazing. Animals are widely used as means of transport, and animal products constitute a substantial part of total production (see Table II). In normal years, there are considerable exports of live animals, raw wool, casings and skins. The leading craft of the country, i.e., carpet-making, is based on local wool. The waste of animal resources is such that of the total goat and sheep population of approximately 21 million, 2 million die annually as a result of the ravages of disease.

Table II
Animal Products
Average 1939-43

	(thousand tons)
meat	200
wool	18
milk	1,235
eggs	44
skins	3

Fisheries:

The fishing industry both in the Caspian Sea and the Persian Gulf is important, and in 1939, annual production was estimated at about .9 million tons. A Russo-Iranian concern, the Societe Mahie Iran, operates the Caspian Sea concession in exchange for an annual royalty and exports the major part of its products to the U.S.S.R.

Mining:

With the exception of oil, no comprehensive survey of Iran's mineral resources has ever been attempted.1/ At present, high-grade iron ore, low-grade copper, lead and antimony are mined in small quantities, and annual coal production amounts to 120,000 tons. Most of the mines are operated by the Government or foreign syndicates, but the Government reserves the right to expropriate any mining concern against payment of "adequate" compensation. The high cost of transport, the antiquated equipment and methods of exploitation resulting in mines being waterlogged, and the dearth of skilled technicians militate against the economical exploitation of the mines. Owing to the pressing need for capital elsewhere in the economy, it is highly improbable that extensive investment will be made in mining in the near future. However, in order to provide Iran's industry with cheap power, the consulting engineers, recently engaged by the Government, have recommended the piping of natural gas from the southern oil fields to the northern regions.

Oil:2/

Iran ranks as the fourth oil-producing region in the world with reserves estimated at 165 billion barrels, or 30 per cent of the world total. In 1946, production was 19.2 million tons, representing an increase of 100 per cent above the maximum prewar annual production. Owing to low internal consumption, the ratio of exports to total production is high (see Table III).

Hitherto, the major bottleneck checking increased production has been the absence of adequate transport facilities. The participation of two American oil companies in financing a new pipeline to the Mediterranean in exchange for a share of the increased output may be confidently expected to lead to a substantial increase in production by 1950.

1/ A company with a capital of £ 1,000,000 was formed in 1890 to exploit the mining concessions granted to the Imperial Bank of Iran, but work did not go beyond the exploratory stage, and the concession has since lapsed.

2/ See RD-395 for further details on the oil resources of Iran.

Table III
Oil Exports from Iran

Year	Quantity (million tons)	Value (million $)
1935-36	6.9	80
1936-37	8.0	96
1937-38	9.5	115
1938-39	9.6	100
1939-40	8.3	100
1940-41	7.0	50
1941-42	5.0	30
1942-43	8.9	100
1943-44	8.4	100
1944-45	10.1	120
1945-46	15.0	172

The main concession is exploited by the Anglo-Iranian Oil Company which pays a royalty of four "gold" shillings a ton on all oil sold in Iran or exported, as well as a tax of nine "gold" pence per ton for the first six million tons of annual production, and six "gold" pence per ton above that figure. The company also pays to the Iranian Government a sum equal to 20 per cent of annual profits after payment of 5 per cent on ordinary stock outstanding in 1932. Finally, it undertakes to sell its products in the local market at less than world prices. Sterling receipts on account of local expenditure by the oil company, royalties, taxes and profits account for about 50 per cent of Iran's aggregate foreign exchange receipts (see Table IV), and are expected to increase with the contemplated expansion of production in the near future. A scheme for a joint Irano-Russian exploitation of the oil deposits of the northern provinces, negotiated in 1946, has been recently turned down by the Iranian Majliss. Owing to the large distances involved, it is unlikely that these deposits will interest British or American capital.

Table IV
Iran's Foreign Exchange Receipts from Oil 1/

Year	Local Expenditure by A.I.O.C.	Royalties, Taxes, and Profits	Total
	(million $)		
1944-45	14	18	32
1945-46	18	22	40
1946-47	41	28	69

1/ In the first five months of 1947, domestic production of crude petroleum was slightly less than the corresponding months of 1946.

Industry:

Some of the traditional crafts of Iran have survived into the twentieth century. Carpet-making, a highly labor-intensive industry drawing on a supply of cheap labor, provides one of the main exports and is supervised by a state monopoly. Handloom-weaving provides village dwellers with part of their clothing requirements. Another important craft is gold and silver enameling. At present, the lack of capital and marketing facilities prevents the growth of these village industries. In the twenties, the government embarked on an ambitious plan of industrialization, backed by the grant of monopolies, protection, preferential treatment in government tenders, and rigorous import control. The government took the initiative in this sphere, owing to the failure of both foreign and local capital to enter industry. The programme was, however, interrupted by the cessation of the import of machinery during the recent war and in its aftermath.

The 150 state factories, the management of which is in the hands of the State Industrial Bank, include textiles, cement, sugar, and flour-milling. The cotton industry is the most important, and there are 150,000 spindles with an annual production of 4,500 tons of yarn and 22 million meters of cloth. Output per spindle is very low, and the number of workers per spindle is very high. The woolen industry with 18,000 spindles produced about 10 million meters a year. The local sugar industry produces 36,000 tons out of an annual consumption of 120,000 tons. The cement plants have an annual capacity of 100,000 tons.

Despite state aid, the number of "industrial workers" does not at present exceed 200,000, of which 40,000 are employed by the Anglo-Iranian Oil Company and 30,000 by the state railways. As in other backward agricultural countries, the obstacles to industrialization have been tremendous. In the first place, coal is scarce, and the generation of electricity has made little progress. (It has been calculated that the annual kilowatt-hour per capita is 6.3 as compared with 41 in Lebanon.) But it is possible in the future to make greater use of the locally produced oil. Secondly, with the prevailing illiteracy, the supply of skilled workers and able administrators is limited. Thirdly, the attempt to finance new industrial investment from the proceeds of taxation and internal saving without recourse to foreign capital has not yielded satisfactory results. The new development plan assigns a minor importance to industrial investment, except in the case of industries based on local raw materials such as canning, flour-milling, textiles, plastics, and chemicals.

Communications:

The system of communications is extremely backward. With a vast territory, Iran has about 3,000 kilometers of single-track railways and 15,000 kilometers of highways; and most of the carriage of goods is still done by animals. The recent war has brought about some improvement in communications and an increase in railway rolling stock. However, there is a pressing need for capital expenditure to extend road and rail facilities to replace dilapidated equipment and to provide "special" cars for the transport of perishable goods. The improvement of communications is the prerequisite for any economic expansion in Iran. It would remove the glaring discrepancies in agricultural prices at present existing between the various provinces and enable the exploitation of hitherto inaccessible regions.

3. Foreign Trade

Until 1941-42, most of the foreign trade of Iran was conducted by monopoly corporations under Government supervision. Government control was designed to foster industrialization, and to ensure sufficient foreign exchange for the purchase of armaments. At present, import licenses are not required, but the authorized banks are obligated to notify the Minister of Trade and Finance of all credits granted, and the quantity and nature of the merchandise involved. Various quotas are established annually for authorized commodities in order to release foreign exchange for the import of capital goods; and when the quota for a particular product is exhausted, the banks are instructed to stop granting further credits for the import of that product. Since February 1947, more liberal allocations have been made for the import of machinery and necessities. With a few exceptions,[1/] announced periodically, the export of Iranian agricultural and industrial products is free. The export of opium, tobacco, and matches is in the hands of the Government.

Table V
Iranian "Commercial" Exports[2/]

Year	Volume (000 tons)	Value (million $)
1935-36	247	40
1936-37	255	41
1937-38	210	41
1938-39	153	38
1939-40	159	45
1940-41	209	54
1941-42	121	32
1942-43	46	17
1943-44	57	22
1944-45	61	24
1945-46	117	52
1946-47	208	76

Between 1935-36 and 1938-39, Iran's "commercial" exports averaged 220,000 tons annually, valued at $40 million, while the export of oil averaged 8.5 million tons valued at about $100 million. The principal exports were handmade carpets (16 per cent), cotton (13 per cent), wool

1/ These include gold, cereals, pulses, animals, cotton and woolen piece goods, and tea.

2/ "Commercial" exports exclude oil and fish exported by the Societe Mahie Iran. For oil exports see Table III.

(10 per cent), gum (7 per cent), opium (7 per cent), casings and lambskins (6 per cent).[1] Owing to the diversity of exports and their relatively stable prices, foreign exchange receipts did not fluctuate within a wide range, as was the case with other Middle Eastern countries. Apart from oil and carpets, Iran's exports were primarily raw materials and foodstuffs, and it is unlikely that there will be a major change in the commodity structure of Iran's exports in the near future owing to the backward state of industry. In recent years, the importance of commercial exports has been overshadowed by the growing importance of oil, the foreign exchange proceeds of which accrue to the concession company.

During the war, the quantum of exports was drastically reduced owing to the prohibition of the export of certain goods, the loss of the European market and the disruption of world trade. Thus, in the three years 1942-43 to 1944-45, the quantum of "commercial" exports was below 30 per cent of the prewar level. During the same period, the export of oil, which had declined in the first two years of the war, was again equal to the prewar average. With the conclusion of hostilities the exports of carpets, dried fruit, rice and gum began to recover, but the process of recovery was retarded by the troubles in the northern province of Azerbaijan, which provides a substantial part of Iran's exports. As a result, the quantum of exports during 1945-46 was about 50 per cent of the prewar level. The greatest decline was in the export of cotton and cereals. The export of the former stopped almost entirely, while that of cereals fell to about 3 per cent of the 1937-38 average. On the other hand, exports of dried fruit, rice, wool and carpets were 60, 80, 34 and 75 per cent of the 1937-38 average (see Table VI).

Table VI
Iran's Principal Exports

	1937-38	(tons)	1945-46
carpets	4,616		3,400
dried fruits	55,155		32,895
cotton	18,105		5
wool	9,794		3,319
skins	3,180		3,612
rice	50,009		40,992
gum	3,064		2,114
casings	487		197
cereals	52,688		1,891
total exports	210,000		117,000

Exports again increased during 1946-47, when their quantum was slightly less than the prewar level. Recent reports indicate that foreign demand during the current year has been slack with a consequential fall in the

1/ These percentages refer to the year 1937-38.

quantum and price of exports. With the return of more normal conditions in world trade, Iran will feel the impact of the disruption of Germany, which before the war was usually Iran's leading customer. Owing to the fact that a large part of Iran's exports consists of "luxury" goods such as carpets and dried fruits, the import of which is not encouraged by countries faced with trade deficits, a decline in the present U.S. demand for these goods would create serious difficulties. Hence the need for encouraging the production of cereals, cotton, and wool, and such other commodities in short supply.

Between 1935-36 to 1938-39, Iran's "commercial" imports averaged 380,000 tons valued at approximately $50 million. They consisted in the main of manufactured goods. Thus, in 1937-38, metal and metal goods, cotton piece goods, machinery, sugar and motor vehicles accounted for 20, 19, 10, 10 and 9 per cent respectively of total imports.

Table VII
Imports

	Quantity (000 tons)		Value (million $)	
	Commercial Imports	Duty-Free Imports 1/	Commercial Imports	Duty-Free Imports 1/
1935-36	434	123	53	15
1936-37	429	152	56	13
1937-38	407	251	57	25
1938-39	242	637	39	35
1939-40	199	656	36	27
1940-41	317	90	33	6
1941-42	249	90	19	6
1942-43	137	239	40	31
1943-44	154	120	47	12
1944-45	126	330	90	14
1945-46	151	520	95	23
1946-47	226	?	118	?

During the war, the quantum of imports fell sharply with disastrous effects on production and the standard of living. After the war, imports increased both in volume and in value, but there was an influx of luxury goods to satisfy the pent-up demands of the well-to-do, which absorbed much of the privately owned foreign exchange accumulated during the war. The drastic decline in the import of essential goods and machinery is shown in the following Table VIII. It will be seen that in 1945-46 the imports of cotton piece goods and machinery fell to 20 and 10 per cent respectively of the 1937-38 level. The shortage of cheap cotton piece goods is particularly acute, and the yearly ration of cotton cloth per person is about three meters.

1/ The duty-free category includes the imports of the Anglo-Iranian Oil Company and other concession companies as well as the imports of Government departments.

Table VIII
Principal Imports

	1937-38	1945-46
	(tons)	
cotton piece goods	8,865	1,819
woolens	809	97
sugar	81,871	48,438
tea	9,712	3,445
machinery	12,076	1,229

In 1946-47, the volume of commercial imports increased considerably as compared with the previous year, but was still 60 per cent of the prewar average. The granting of liberal foreign exchange allocations for the import of essential goods has to a certain extent redressed the balance between essentials and luxuries.

Table IX
Geographical Distribution
of Iran's Foreign Trade

	1937-38	1945-46
U.S.S.R.	36	24.5
Germany	21	—
U.K.	8	7.5
India	8	16
U.S.A.	10	23.9
Others	17	28.1

The geographical distribution of Iran's "commercial" foreign trade is shown in Table IX. Before the war, Germany and the U.S.S.R. were the principal customers and main suppliers of Iran,[1] while the U.K. and the U.S. were relatively less important. After 1941, trade with Germany and Japan stopped, while India and the U.S.A. became prominent among Iran's trading partners. The efforts of the Middle East Supply Center helped to stimulate trade with the Near East. In the postwar period, the inability of Europe to meet Iran's need for industrial goods has resulted in increased reliance on the U.S.A. According to U.S. statistics, Iran's imports from the U.S.A. during the first nine months of the current year amounted to $25.6 million, while U.S.A. imports from Iran were $16.1 million, indicating an annual deficit of $12.7 million.

1/ The greater part of the exports of oil went to the U.K., the Union of South Africa and Egypt.

Table X
U.S. Trade with Iran
(thousand $)

	Exports (including re-exports)	General Imports
1946	22,147	31,192
1947		
January	3,118	5,346
February	2,831	769
March	499	594
April	4,056	2,639
May	3,505	8,205
June	4,336	1,600
July	2,602	1,835
August	2,669	270
September	2,023	659
January-September	25,642	16,050
Monthly average 1947	2,850	1,783

As most of Iran's foreign exchange receipts are in sterling, this deficit with the U.S. has caused a substantial rise in the free dollar rate. A partial solution of Iran's dollar problem is afforded by the recent monetary agreement with the U.K. which allows the convertibility of Iran's sterling balances for the payment of imports unobtainable in the U.K.

Between 1940-46, the wholesale price of exports rose steadily from 122 in December 1939 to 512 at the end of 1946, as a result of world scarcities, coupled with the devaluation of the rial in 1941. However, this substantial rise is not a serious impediment to exports, as exporters are allowed to sell 90 per cent of their foreign exchange receipts at the free rates, which are quoted at varying premia over official rates. The war-time rise in the wholesale import price index was much more pronounced than that of exports, and in December 1939, it stood at 796 (1937 = 100).

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However, it began to fall very sharply, and by December 1946 had fallen by 32 per cent as compared with the corresponding month of 1944.

4. Money and Prices

The monetary unit is the rial introduced in 1932, at the time of the suspension of gold convertibility. Linked to sterling in 1936 at the rate of 80.5 to the sterling, the rial was in 1939 linked to the dollar at the rate of 17.11 rials to the dollar. Since 1942, the official selling rate has been maintained at 32.5 rials to the dollar and the buying rate at 32, but there is an important free exchange market which will be described in the next section.

The law of November 19, 1942 vests the control of note issue in the Banknote Reserve Control Board. The law makes a distinction between notes issued prior to and notes issued subsequent to its promulgation. The former, amounting to 3,500 million rials, are covered as follows:

(million rials)

1435	gold
320	silver
344	crown jewels
1400	Government debt
3499	

Notes issued in excess of 3500 million must be covered as to 60 per cent in gold, valued at the official rate prevailing in the international market, sterling, or dollars convertible into gold; the remaining 40 per cent must be in sterling or dollars guaranteed against depreciation in terms of gold. Thus, the increase in the note issue during the year 1945-46, amounting to 250 million rials, was covered by an equivalent increase in the gold and foreign exchange holdings of the Note Issue Department of the Bank Melli.

In July 1947, the note cover[1/] consisted of gold (55.34 per cent), foreign exchange (22.25 per cent), Government debt (17.95 per cent), and crown jewels (4.41 per cent). The present note cover requirements are too high for a poor economy, and result in the immobilization of the country's external reserves. A reversion to the 60 per cent prewar reserve requirement would release substantial quantities of gold and foreign exchange as a masse de manoeuvre for the Central Bank.

During the war, the economy of Iran was subjected to severe inflationary pressure as a result of (a) the huge volume of purchasing power generated by Allied military expenditure, (b) the large investment in transport, (c) the financing of successive budget deficits by borrowing from the Central Bank, (d) the decline of production owing to the diversion of workers to

1/ The silver holdings of the Issue Department have gradually been replaced by gold.

military needs, (e) the scarcity of imports of both consumers' and capital goods and the increase in speculation and hoarding,[1] despite the promulgation of "anti-hoarding laws", owing to the decline in confidence in the currency, and (f) the failure of the administrative machinery, even when backed by foreign specialists, to curb the continued rise in prices.

The note circulation which stood at 1 billion rials at the end of 1939 rose to 6.6 billion in December 1945, and bank deposits rose from .20 billion rials in August 1939 to 5.7 billion rials in December 1945. This large increase in the money supply was reflected in the price indices. During the period under review, the cost-of-living index rose from 121 to 779 (1937 = 100), while the "general" wholesale index rose from 118 to 519 (1937 = 100). The index of money wages also rose appreciably.

With the decline of Allied military expenditure and the emergence of an import surplus following the partial resumption of foreign trade, the main inflationary pressure was halted. Since March 1945, there has been no marked increase in the volume of note issue though the amount held by the public rose slightly, and there was some increase in bank deposits (see Table XI).

Table XI
The Money Supply
(billion rials)

Date	Note Issue and coins	Cash at the banks	Held by the public	Deposits with the banks
March 21, 1945	7.9	2.2	5.7	5
March 21, 1946	7.7	1.8	6.	5
March 21, 1947	8.0	1.4	6.6	5.7

Despite the persistence of scarcities, there has been a partial reversal of the wartime inflationary rise in prices. The cost-of-living index which reached a peak in the middle of 1945, especially for food and clothing, began to decline, and in January 1947, it was 10 per cent below the corresponding month of 1946. Little change has occurred since, the fall in food prices being counteracted by a rise in rents. The general wholesale price index also fell since the peak of 1945, and in January 1947, it was 5 per cent below the corresponding figure of the previous year, but there has been a slight deterioration during the first five months of the current year. Moreover, money wages, which by the beginning of 1946 had increased eightfold as compared with 1936, remained almost constant in the course of the year.[2]

The influence of the deflationary forces mentioned above has been partly nullified by the persistence of budget deficits and by large military appropriations, the troubles in Azerbaijan and elsewhere, the release

1/ To counteract hoarding, the price of wheat was trebled in 1942.
2/ Real wages were about the same as in 1936.

of pent-up demand and the rise in world prices, especially in the U.S.A. The failure of the imports of essential goods to reach prewar levels has caused the persistence of scarcities in the local market. Although inflation has been receding somewhat, it is highly unlikely that prices will revert to the prewar level. A substantial increase in the import of consumers' and of capital goods would have the dual effect of increasing supplies and of absorbing the excessive purchasing power in the hands of the public. A bolder tax policy would also relieve some of the present pressure on prices, but in the present conditions of Iran, such measures as the blocking of bank accounts and the control of consumption and prices are not feasible. Moreover, the increase in oil production and the contemplated investment plan would increase incomes and enable Iran to sustain a higher level of prices.

5. The Banking System

The central bank of Iran is the Bank Melli (capital 300 million rials) which is entirely state-owned. It is the Government's banker and, since 1931, has enjoyed the sole right of note issue. It carries out an extensive banking business with branches all over the country. The main commercial banks are (1) the Imperial Bank of Iran (capital £ 1 million), which prior to 1931 had the exclusive right of note issue, (2) the Ottoman Bank, (3) the Banque Russo-Persane, which is primarily concerned with the finance of trade with Russia, and (4) the Sepat Bank, an Iranian concern, with a capital of approximately £ 1 million, engaged partly in commercial banking, and partly in keeping the accounts of the Army. There is a loan bank advancing funds for house building, and a number of agricultural and mortgage institutions for the supply of agricultural credit. The Agricultural Bank of Iran (paid-up capital 180 million rials), which prior to 1933 was a department of the Bank Melli, but has since existed as a separate entity, grants mortgage loans especially to producers of cash crops. As it insists on collateral, the bank is not open to the landless peasants who have to resort to Zamindaris, merchants and usurers for loans at rates of interest sometimes reaching 50 per cent. Finally, there is an industrial bank which supervises and finances state-owned enterprises.

The Bank Melli is developing on central banking lines. It has recently been given some authority over commercial banks. These are now required to deposit 15 per cent of current deposits and 6 per cent of fixed deposits in a non-interest bearing account with the Bank Melli. Moreover, banks in Iran undertake to hold the equivalent of 15 per cent of current deposits and 6 per cent of fixed deposits in the form of Iranian Government treasury bonds. They are also required to submit fortnightly statements of accounts to the Bank Melli. However, in view of the simple character of the economy and the absence of well-developed bill and security markets, the powers of the Bank Melli to influence the course of credit are rather small.

During the war, and again in the first postwar year, the Bank Melli pursued a policy of qualitative and quantitative credit control. It declined to finance the holding of excessive inventories, and raised the bank rate and other interest rates in an attempt to counteract the inflationary pressure from Allied military expenditure and from deficit financing. However, the rate of interest on loans against commodities at the Bank Melli was reduced from 12 per cent at the end of 1945 to 9 per cent in December 1946, and interest rates generally remain fairly high. In the latter month, the rate of interest on first-class signatures was 24 per cent, while that on second-class signatures was 30 per cent. Municipalities and state enterprises receive loans at rates varying between 4 and 6½ per cent. The more liberal credit policy, pursued by the Bank Melli Iran in 1946-47, is reflected in the increase in the items "bills discounted" and "debtors" in the statement of accounts.

The Bank Melli has also attempted to curb inflation by the sale of gold in the local market to absorb the excessive purchasing power in the hands of the public. Gold sales in 1944-45 and 1945-46 averaged 175 million rials; they fell in 1946-47 to 61 million rials. The sale of gold in the open market drove the price of the gold "pahlavi" from 750 rials in February 1946, to 550 in February 1947.

6. Balance of Payments and Exchange Resources

Between 1935-36 and 1938-39, Iran's deficit in the balance of "commercial" trade averaged $10 million annually, but it received large amounts of foreign exchange on account of oil royalties, the Government's share in the profits of the Anglo-Iranian Oil Company and the Company's purchases of local currency for current and capital expenditures in Iran. Before the war, foreign exchange receipts from sources other than "commercial" exports provided on the average a third of total foreign exchange receipts. In 1945-46 and 1946-47, the trade deficit amounted to $40 million, and was covered by the much-increased royalties. In these two postwar years, foreign exchange receipts from sources other than "commercial" exports accounted for 50 per cent and 45 per cent respectively of total foreign exchange receipts.

No comprehensive statement of Iran's balance of payments is available, but the following table gives an idea of Iran's international accounts during 1946-47.

Table XII
March 21, 1946 - March 21, 1947
(million $)

	Receipts	Payments
Commercial trade	76	118
Oil royalties, taxes and profits	28	
Local expenditure of A.I.O.C.	41	
Net payments on other items		20
	145	138
Increase in gold and foreign exchange holdings of the Bank Melli (Issue and Banking Departments)		7

The large trade deficit for 1946-47 was more than counterbalanced by other receipts, and there was some increase in the Central Bank's gold and foreign exchange holdings. The future balance of payments prospects are not clear. The import surplus is likely to continue in the near future. On the other hand, receipts on account of oil have increased during the last three years, and are likely to increase further after the completion of the proposed pipeline to the Mediterranean. The prospects for "commercial" exports depend on the revival of the European economy and the maintenance of the present level of exports to India and the U.S.A., the latter being the principal market for Iran's luxury carpets. The recovery of cotton and cereal production to the prewar level would increase the export of goods with a large world demand. At the present low level of imports per capita, Iran's foreign exchange receipts are adequate for its immediate needs, but if a large program of capital investment is undertaken and a substantial rise in consumption and real incomes ensues, it might cause a deficiency in Iran's balance of payments. Such a situation may lead to the gradual loss of accumulated official and private holdings of gold and foreign exchange, which have substantially increased since before the war.

After the suspension of sterling convertibility, Iran began to feel more acutely than hitherto the prevailing crisis of international payments arising from the inconvertibility of European currencies and the overwhelming need for supplies from the dollar area. Thus, Iran has £ 20 million accumulated sterling balances and large annual sterling earnings estimated at between £ 18 and £ 20 million on account of oil royalties and the purchases of local currency by the oil company. On the other hand, its dollar earnings during 1946-47 were estimated at about $21 million against expenditures of $29 million.

However, owing to the importance of the oil concession to the U.K., a financial agreement was reached on November 8, whereby Iranian sterling balances on November 6 became convertible into other currencies for the purpose of paying imports unobtainable in Britain. Moreover, these balances will henceforth carry a guarantee against depreciation in terms of gold.

Iran has accumulated large official gold and foreign exchange holdings as a result of balance of payments surpluses totalling $150 million between 1941 and 1944. With the wartime relaxation of exchange control, dollars became available for capital exports, and private holdings became substantial. In 1945, however, Iran's official gold and foreign exchange holdings[1] were reduced by about $50 million, but since then, they have increased slightly (see Table XIII), and at present, gold and dollar holdings amount to about six times Iran's present quota in the Fund.

1/ Both in the Issue and in the Banking Departments of the Bank Melli.

Table XIII
Gold and Foreign Exchange Holdings
of the Bank Melli
(millions of rials and U.S. dollars)

	March 21, 1945	March 21, 1946	March 21, 1947
Gold in the Issue Department	4158	4014	4219
Gold in the Banking Department	196	109	109 1/
Total gold	4354	4123	4328
Foreign exchange			
in the Issue Department	1538	1481	1719
in the Banking Department	2926	1649	1527
	4464	3130	3246
Total gold and foreign exchange	8818	7253	7574
In U.S. dollars	274	223	230 2/

7. The Foreign Exchange Market

In 1936, when the rial was linked to sterling, a system of multiple exchange rates involving discrimination as between various categories of goods was adopted. The lowest rate, 80.5 rials to the sterling applied to the trade in government monopoly goods such as tea, sugar and tobacco. The other three rates, with varying surcharges, applied to the trade in non-monopoly goods, the export of antiques, and tourism. In 1941, the multiple rate system was discontinued and a single rate was adopted, which was raised in the following year.

Under the system prevailing in Iran since the spring of 1946, when effective exchange control was re-introduced, an important free market in foreign exchange exists side by side with the official market. Iranian exporters and other recipients of foreign exchange are required to sell part of their receipts at the official rate of exchange to either of the two authorized banks, the Bank Melli and the Imperial Bank. (Since 1942, the official rate has been maintained at 32-32.50 rials for the dollar and 128-130 rials for sterling, rates for other currencies being fixed by the Bank Melli.) The remaining part is sold to the same banks at the free rates which are quoted at varying premia and discounts over the official rates.

The official market, where foreign exchange is bought and sold at the official rates, derives its funds from four sources: (1) the sale by the Government of its sterling receipts on account of oil, (2) the sterling paid by the Anglo-Iranian Oil Company for the purchase of local currency

1/ The balance sheet of the Bank Melli for 1947 does not give the figure for gold in the Banking Department separately, and in this table the 1946 figure was used.

2/ In June 1947, official holdings included $140 million in gold, 15.3 million U.S. dollars and £ 21.1 million.

for current and capital investment, (3) 10 per cent of the declared value of exports, which exporters are obligated to sell at the official rate, (4) 10 per cent of foreign exchange receipts from sources other than exports.

The government and the importers of specified goods acting as agents of the government are provided with exchange at the official rate, the Exchange Commission supplying foreign exchange within the limits of the import quotas, provided that it has sufficient amounts of the currency required. At present, the goods for which foreign exchange is provided at the official rate include industrial and agricultural machinery, spare parts, trucks, cotton piece goods, chemicals, as well as the requirements of government departments and state-owned commercial and industrial enterprises.

The supply of funds in the free market emanates from (1) the 90 per cent of foreign exchange receipts which exporters and other recipients are allowed to sell to authorized banks,1/ (2) the difference between the declared value of exports and their real value. The free market caters for the importers of goods other than government monopoly goods.

The basic features of the existing exchange rate structure are (1) the existence of a fluctuating buying rate, being the weighted average of the free and official rates applicable to exporters and other recipients of foreign exchange and a fixed buying rate applicable to the oil company, (2) the maintenance of a fixed selling rate for essential imports side by side with a fluctuating rate for "non-essential" imports, (3) the disparity between official and free market cross-rates and the frequent changes in the latter.

Table XIV
Free Market Quotations

1946-47	rials to the $	premium (per cent)	rials to the £	premium (per cent)
Sept. 4, 1946	51-51.5	59	175	36
Oct. 30, 1946	49.5-50	56	131	2
Nov. 27, 1946	54.5-55.25	72	132	3
Dec. 25, 1946	51.25-52.5	62	131	2
Jan. 29, 1947 2/	51.75-52.25	59	144	12
Feb. 26, 1947	52.25-52.5	62	165	28
Mar. 26, 1947	51.5-51.25	59	152	18
April 2, 1947	51.5-51.6	59	-	-
July 15, 1947	60	88	182	42
September 1947	76	140	-	-
end of November 1947	65	103	225	76

1/ Since March 1946, all exporters are required to surrender 100 per cent of their exchange receipts, but are allowed to repurchase 90 per cent of the export proceeds. In practice, they are given export sales certificates which they sell in the open market, thereby transferring their rights of repurchase to prospective importers.

2/ In January, the French franc was quoted at a discount and the premium for the Swiss franc was about 90 per cent.

The free market rates fluctuate with changes in the conditions of supply and demand for various currencies, especially as exports have a marked seasonality, while imports are more or less regular. The changes in the cross-rates, reflect the varying degree of confidence in the currencies traded, and the extent to which the exchange control authorities grant different kinds of foreign exchange for various purposes at the official rate. Thus, the rise in the free dollar rate during 1944-45 was due to the refusal of authorized banks to sell dollars for capital transfers, and the curtailment of the sale of dollars for other non-commercial purposes. The rise in the rate of sterling early this year was due to the fact that, after the liberal granting of sterling, further sales of sterling at the official rate were limited to the importation of essential goods and the increased demand for sterling following Iran's joining the U.K. transferable account network. The relatively high stability of free rates in the early part of this year is due to the large supply of free exchange derived from exports. The rise in the free dollar rate in September is attributable to (a) the increased demand for imports of sugar from the dollar area after the abolition of international control on the distribution of sugar, (b) the fall in the quantity and value of Iranian exports to the U.S.A. since May, and (c) the gradual decline in private holdings. The fall, which occurred in November, is a result of the decline in demand for free dollars at the prevailing high rates. The rise in free sterling is due to the large American demand for sterling to be transferred to the Russian account in London in settlement of shipments of fur from the U.S.S.R. to the U.S.A., such transfer having been recently permitted by the U.K. The recent rise in free sterling narrows the gap hitherto existing between free market and official cross-rates.

Since 1945, the fall in Iranian prices and the rise in U.S. prices led to a decline in the degree of overvaluation of the rial. On the basis of wholesale prices, the overvaluation of the rial in relation to the dollar fell from 210 in 1945, to 164 in December 1946, and to 160 in May 1947. On the basis of the cost of living, the overvaluation of the rial in relation to the dollar fell from 290 in 1945, to 230 in December 1946, and to 220 in May 1947. If the free rate is taken as the basis of comparison, the overvaluation of the rial in 1945 was about 30 per cent in relation to the dollar. By December 1946, it had been reduced to 10 per cent and had fallen even more by July 1947.

Appraisal:

The present multiple exchange system which involves both discrimination as between various classes of imports and fluctuating rates, is the result of the overvaluation of the rial at the official parity. It is ostensibly intended to foster exports, to subsidize essential imports, to curtail the imports of non-essential goods not falling within the prohibited list, and to secure larger foreign exchange receipts from the local expenditure of the oil company.

The free rate certainly permits the continuation of exports in spite of the high level of internal prices, and maintains the large sterling receipts from the oil company. However, one of the important objects of the system, namely, the procurement of cheap imports, is defeated by continued world scarcities, the insufficiency of allocations, and the fact that importers are able, in the absence of price ceilings, to sell the limited supplies at the prevailing high prices. The system is thus tantamount to the granting of a subsidy to importers.

If the rates obtaining in the free market, where approximately 50 per cent of Iran's international business is transacted, remain stable for a prolonged period at lower premia than those at present existing, it might be possible to curtail the scope of the free market by adjusting official rates to the level of free rates. The devaluation would have little effect on exports which are governed by the free rate[1] but would reduce sterling receipts in respect of the company's purchases of local currency. At the present free rate of 225 rials to the pound sterling, the loss would be of the order of magnitude of 50 per cent, but early in the year when the free rate was only slightly above the official rate, the loss would have been negligible. This factor is extremely important, as the terms of the concession preclude the possibility of levying an additional tax on the company to compensate for the difference between the official and the free rates.

On the other hand, devaluation, while not affecting the imports of "non-essentials", would raise the rial cost of imports of essential goods, but this could be remedied by a combination of taxes and subsidies, especially as the Government would profit from the sale of its foreign exchange receipts at the depreciated rate. However, the devaluation should be preceded by a prolonged period of stability in the free market, during which encouragement is given to the production of goods in urgent world demand, tighter import controls designed to reduce the import of non-essential goods are imposed, and the large official gold and foreign exchange holdings used to stabilize the new rates. Besides their anti-inflationary effects, such sales would permit the import of machinery and fertilizers to stimulate production and exports.

8. Public Finance

Table XV
The Budget 1939-40/1946-47 [2]
(million rials)

	Revenue		Expenditure	
1939-40	1,930		2,613	
1940-41	3,094		4,210	
1941-42	3,614		4,323	
1942-43	3,138		3,138	
1943-44	7,686	1891 ordinary 5795 commercial	9,194	3297 ordinary 5897 commercial
1944-45	10,325	3958 ordinary 6367 commercial	10,325	4569 ordinary 5756 commercial
1945-46	4,630		4,560	
1946-47	5,850 [3]		6,100 [4]	

For footnotes see following page.

Table XV shows the growth of the Iranian budget since fiscal 1939-40. Owing to the fall in production and foreign trade, the failure of the administration to collect taxes, the political need for subsidizing the price of bread and the serious inflation, there has been a series of war-time public deficits, the magnitude of which is, however, exaggerated by faulty accounting practices. These public deficits were met by borrowing from the central bank. Thus, Government indebtedness to the Bank Melli Iran rose from 2 billion rials in March 1942 to 5 billion rials in March 1947. A hopeful sign is that during the last two fiscal years, Government borrowing from the Bank was on a much reduced scale as compared with previous years. By budgeting for a surplus within the next years, the Government can help the course of deflation, thereby redressing some of the inequalities created during the war.

In fiscal 1943-44, the budget was divided into two sections. The first comprised ordinary receipts and expenditures, while the second, or commercial budget, comprised the receipts and expenditures of state enterprises, ceded properties and the Ministry of Food. In 1945-46, the government reverted to the earlier practice of separating the accounts of government enterprises from the general budget, and only the sum of 500 million rials is now included in the general budget as net income from state enterprises.

The present system of public finance is the outcome of the reforms of the twenties when a budget on modern lines was introduced and public accounts were separated from those of the Shah. A cadastral survey was then undertaken and the basis for assessing land taxes was revised. Antiquated taxes and tolls were abolished, and income taxes and stamp duties were introduced for the first time. Moreover, the tariff was modernized and a new tobacco excise introduced. At present, government revenue probably represents about 13 per cent of the national income.

Footnotes from preceding page.

1/ The obligation to sell 10 per cent of the declared value of exports at the official rate is counterbalanced by the fact that exporters actual receipts are generally above the values they are required to declare.

2/ Figures are budget estimates, except for fiscal 1945-46, which are actual receipts and payments.

3/ Approximately $182 million.

4/ Approximately $190 million.

Table XVI
Public Revenue
Estimates for 1946-47

		(million rials)	per cent
"direct" taxes			
(income, stamp, inheritance)		588	11
indirect taxes			
customs	1331		
taxes on kerosene and petrol	192		
excise, etc.	139	1662	30
(1) total tax revenue		2250	
state monopolies			
opium	142		
tobacco	1234	1376	25
royalties			
oil	677		
fisheries	6	683	13
income from state domain, post and telegraph, other government enterprises and other revenues		1108	21
(2) total non-tax revenue		3167	
total revenue (1) and (2)		5417	100

Table XVI reveals the importance of income from state monopolies, royalties and state enterprises in Iran's system of national finance. In 1946-47, the opium and tobacco monopolies accounted for 25 per cent of total revenue, while oil royalties accounted for approximately 13 per cent. Oil royalties, which increased threefold in the thirties, are likely to increase still further both absolutely, and relatively to total revenue. However, if the views expressed in certain quarters are heeded, the state would turn over to private enterprise the greater part of its industrial and commercial enterprises and tax receipts would undoubtedly expand at the expense of non-tax receipts.

As in most economically less advanced communities, customs receipts play a major role in state finance. In 1946-47, they amounted to over 25 per cent of total revenue while direct taxes accounted for only 11 per cent. This glaringly regressive character of the tax system is further aggravated by the fact that most of the income of state monopolies is derived from the sale of such items of wide consumption as tobacco, sugar and tea. With improvements in administration, it will be possible to impose "direct" taxes and put an end to the widespread evasion of existing ones.

Table XVII
Public Expenditure
Estimates for 1946-47

	(million rials)
Court and cabinet	53
Labor and propaganda	43
Internal security	1037
Defense	1542
Justice	132
Health	178
Foreign affairs	78
Education	517
Post and telegraph	202
Agriculture	180
Commerce and industry	39
Roads and railways	230
Ministry of Finance	312
Customs, monopolies, public works, extraordinary expenditure	986
Other expenditure	565
	6094

A salient feature of the Iranian budget is the relatively large expenditure on national defense and internal security. In 1946-47, these absorbed over 40 per cent of revenue, while health, education, agriculture, commerce and industry received only 15 per cent. In the present strained political situation, no radical reduction in defense appropriations could, however, be expected. In the interwar period, state investment in transport accounted for about 30 per cent of total revenue, but the absence of facilities for the import of transport equipment on a large scale is at present preventing increased public investment in transport.

The external public debt of Iran consists of a sterling loan of under £ 1 million, and a $25 million surplus property loan granted by the U.S.A. The internal debt is composed of the 5-billion-rial debt to the Bank Melli, as well as an unknown amount of treasury bills.

The Government of Iran has recently announced its intention of carrying out the plan of capital investment which an American engineering firm had been commissioned to prepare. This plan lists a series of projects costing approximately $1300 million to be spent on agriculture, mining, industry, education and sanitation. They have recommended a programme costing $500 million, and failing this, they set forth a more modest one costing $250 million, about a third of which would be spent on agricultural development. Internal financing would impose an intolerable burden on the population by reducing the already low standard of living. For the implementation of these programmes, Iran is therefore seeking a loan from the International Bank for Reconstruction and Development. Moreover, the Bank Melli is hoping to attract private capital for specific projects, and to that end, it has recently announced its readiness to guarantee the repatriation of reasonable yields and of capital.