# CHAPTER ONE

## OVERVIEW

With the overall improvement in general economic conditions during the first year of the Third Five Year Development Plan (3$^{rd}$FYDP), Gross Domestic Product (GDP) grew by 5.1 percent exceeding the projected target figure of 4.5 percent for the first year of the plan. This increase could, in turn, help in achieving one of the plan's overall aims of curbing inflation and increasing employment. The positive upturn in the oil market along with implementation of new foreign trade regulations improved the Balance of Payments (BOP) picture. The increase in the share of Iran's quota in OPEC, which resulted in a rise in production of crude oil and oil products, created a boom in economic activities.

In comparison with the preceding year, the improvement in economic conditions helped to dramatically reduce the inflation rate to a figure of 12.6 percent, the lowest level recorded in the last decade. The improvement in the government's overall fiscal and foreign exchange position, the stabilization of the foreign exchange market, and the reduction of inflationary expectations, were amongst the main factors which effected the inflation rate reduction for the year under review.

The 1379 general budget was compiled within the provisions as set forth in the 3$^{rd}$ FYDP, which proscribed any borrowing from the banking system in the first year of the plan. With this in mind, the government focused attention on job creation, support for economically underprivileged sectors of society, and balancing of its expenditures in line with available revenues. In this respect, both government and Parliament, whilst noting the probable extent of the improvement in world crude oil prices, projected figures for expected oil revenue receipts in the 1379 budget, at relatively lower prices. Therefore in the 1379 approved budget, the government's general revenues and expenditures, excluding special revenues and expenditures, were set at Rls. 107,020.2 billion and 111,335.5 billion, respectively.

In the first fiscal year of the 3$^{rd}$ FYDP, 97.8 percent of the government's general revenues were realized, registering a 13.4 percent growth in comparison with the approved budget figure and amounting to Rls. 104,640.8 billion. In percentage terms, of overall government revenues 56.8 percent was derived from oil revenues, 31.4 percent from taxes, and 11.8 percent from other revenues. The government's general expenditures grew by a far smaller percentage than the increase registered in the previous year i.e.17.3 percent as against 31.4 percent, and reached the figure of Rls. 109,407.1 billion. This represented 98.3 percent of the expenditure as approved in the budget law. Of overall government expenditures, 78.5 and 21.5 percent were respectively made up of current and development expenditures, which amounted to Rls. 85,847.3 billion and 23,559.8 billion, respectively.

Owing to the government's general expenditures exceeding its revenues, the general budget showed a deficit of Rls. 4,766.3 billion, which was mainly financed through the issuance of Participation Papers. Moreover, for the first time after the establishment of the Oil Stabilization Fund (OSF), the government repaid a portion of its indebtedness resulting from foreign exchange losses to the Central Bank (CBI). The outstanding balance of this account at the end of the first fiscal year of the 3rd FYDP showed a reduction of Rls. 1,780.4 billion, in comparison to 1378.

The external sector of the economy showed positive developments in 1379. The 36 percent increase in crude oil prices from $18.60 per barrel in 1378 to $25.30, brought about a marked improvement of 42 percent growth in export revenues. The BOP surplus resulting from this increase made possible the repayment of a sizeable portion of external debt, an increase in the net foreign assets of the banking system and the CBI, and also enabled the creation of the OSF. In addition to a reduction of 2.8 percent in the government's foreign exchange obligations, actual external debt fell by 23 percent. The net repayments of rescheduled contracts and oil pre-finance and finance agreements, were the main factors in reducing both the country's long-term and total external debt.

Non-oil exports grew by 6.1 percent and reached $ 4,181 million in 1379. The increase in export revenues, together with improvements in foreign trade regulations, resulted in a growth of 12.3 percent in imports. The relatively limited increase in imports, as compared to the sizeable 35.3 percent growth of exports, raised the trade balance to $13,375 million.

Among policies implemented in external sector of the economy in 1379, was creating transparency in the foreign exchange market, reducing non-tariff barriers and deregulating administrative routines in import procedures, and easing the regulatory conditions for non-oil exports. The "export rate" was eliminated from the foreign exchange allocation system, and the import certificate was replaced by the Certificate of Deposit (CD).

The upturn in the crude oil market caused foreign exchange revenues to substantially increase during this period. In October 2000, Parliament approved an amendment to the 3rd FYDP Law. This amendment required the government to set up an 'Oil Stabilization Fund', and transfer oil revenues in excess of the figures projected in approved budget into this fund. The main objective for the establishment of OSF was to convert these excess revenues received from the sale of crude oil into other forms of reserves and investments.

In the year under review, one of the main objectives of the economic policy makers was to introduce and utilize indirect instruments of monetary policy. In this respect, on the basis of the 3rd FYDP Law, the CBI was authorized to issue Rls. 3,000 billion Participation Papers with a 6-month maturity at a provisional 19 percent profit rate. However, as the authority for the issuance of these papers was not granted till nearly the end of the year, these instruments had no significant effect in absorbing liquidity. Only Rls.1, 593.1 billion of the issued Participation Papers, were subscribed to by the end of the year. Monetary base grew by 17.5 percent in this year, owing to a marked growth in CBI's assets. Moreover, money multiplier grew by 10 percent and reached the figure of 2.952. Liquidity grew by 29.3 percent as compared to 20.1 percent for the previous year and reached Rls. 249,110.7 billion. Inspection of the factors affecting these changes in liquidity indicate that the increase in this variable has been mainly due to internal factors, the major item being the increase in non-public sector debt in the review year. The effect of changes in the banking system's net claim on the public sector in terms of liquidity on the other hand, was negative.

The volume of money, due to a substantial rise in sight deposits, grew by 31.9 percent in 1379 as against 16 percent in 1378. This resulted in the share of money in the composition of liquidity, in comparison to that of quasi-money, to increase. The increase in the share of sight deposits in the composition of liquidity was higher than that of time deposits.

Stock market activities showed marked growth in 1379 as compared with the previous year. This was mainly due to the growth in manufacturing sector transactions and also reflected relative stability in the foreign exchange, gold, and automobile markets. The ratios of the Rial value of transactions to the average of liquidity and GDP were, respectively, 4.26 and 1.67

percent. Although this figure is indicative of the small size of Tehran Stock Exchange (TSE) when compared with other stock markets in the world, it shows a relative improvement of the capital market position as compared with the respective ratios for the previous year i.e. 2.93 and 1.25 percent.

During the first year of the 3rd FYDP, government support policies in the agriculture sector were continued. These supports took the form of distribution of inputs at reduced prices, guaranteed purchase of major agricultural crops, and the provision of banking facilities at preferential rates. However, owing to unfavorable weather conditions during the year, overall yield figures for major farming crops declined. This decline was due to both decreases in areas under cultivation and in the per-hectare yield figures. An examination of the figures relative to farm crops indicates that production of grains i.e. wheat, barley and rice, declined by 9.8 percent in comparison with the previous farming year and totaled 11,745 thousand tons. This was 6,943 thousand tons or 37.2 percent less than the projected amount in the 3rd FYDP for this year's production. In addition, production figures for major industrial crops such as cotton, tobacco, sugar beet, and oil seeds also declined. In 1379, the two ministries of Jihad Sazandegi and Agriculture were merged into a new ministry entitled the Ministry of Agriculture Jihad.

There was a net increase of 12.6 percent in the subsidy paid to this sector in this year as compared to the previous year, which represented 1.37 percent of GDP. The facilities extended by the banking system to this sector increased by 31.1 percent and amounted to Rls. 29,653.5 billion. Part of this increase was due to rescheduling of farmers' indebtedness because of the continuing drought conditions.

In 1379, in light of OPEC's decision to stabilize crude oil prices, Iran's crude oil production registered an 8.5 percent growth, and reached 3.7 million b/d. Crude oil exports also increased by 12.8 percent to reach 2.3 million b/d, whereas in 1378, crude oil exports had declined by 5.7 percent owing to a reduction in Iran's crude oil production. The largest share in the export of crude oil was to Asian countries and amounted to 61.5 percent of the total oil exports for the year under review. Domestic consumption of oil products declined to 1.1 million b/d, which was 2.8 percent less than the previous year, while domestic prices for oil products increased by 10 percent on average.

The improvements in the government's overall fiscal position and the surplus in BOP, along with the adoption of appropriate monetary policies, effected stability in both prices and the foreign exchange rate. This reduced inflationary expectations and allowed support for manufacturing and mining sectors during the first year of the implementation of the 3rd FYDP. As a result, the value-added for the manufacturing and mining sectors in 1379, at constant 1369 prices, increased, respectively by 8.0 and 6.5 percent, as compared with the preceding year. In this year, Rls.765.9 billion was allocated from the budget for the implementation of national development projects in the manufacturing and mining sectors and for industrial research programs. This was a 62.4 percent increase over the figure realized for the previous year. Moreover, by the end of the year, the amount of outstanding facilities extended through the banks and credit institutions to the non-public manufacturing and mining sector had risen by 30.1 percent to reach Rls. 39.4 thousand billion.

Due to implementation of government support policies for non-oil exports, the value of exports of industrial products registered a 29.8 percent increase and reached $1.9 billion. This is significant when compared to the 11.4 percent figure that was the average envisioned growth figure in the 3rd FYDP for export of industrial products.

A new Ministry of Industries and Mines was created both in line with objectives stipulated in the 3rd FYDP Law in respect to reforming policy-making and administrative infra-structural aspects of the manufacturing and mining sectors, and with another approved Parliamentary bill which called for the 'centralization of manufacturing and mining affairs'. New foreign exchange and trade regulations were pronounced and the government, by allocating funds from the OSF to provide foreign exchange facilities to manufacturing entities, paved the way for the renovation of private sector industrial units.Production of major industrial goods increased favorably in this year, so that amongst 83 selected industrial goods, 49 registered an increase in production.

The trend of economic indices for the construction and housing sector in 1379 denotes a boom in this sector's activities and achievement of the targets as set forth for the first year of the 3rd FYDP. The value-added figure for the construction sector, at constant 1369 prices grew by 8.7 percent. The trend in the increase of housing prices that commenced at the end of 1378 continued in 1379, especially in Tehran, and was due to the demand for housing units exceeding the available supply. Private sector investment in new construction in urban areas showed a 30.4 percent increase as compared with the previous year and reached Rls. 28.8 thousand billion. Review of construction permit data, issued by the municipalities, indicates a continued boom in construction activities, especially in Tehran. The number of permits issued and the total proposed floor-space of new construction licensed by those permits, as granted by the Tehran municipality, registered a 60.2 and 61.0 percent increase respectively when compared with the previous year. Governmental development expenditure in this sector grew by 30.0 percent and was amongst the factors leading to the boom in 1379. Government development expenditures took the form of national and provincial construction programs and urban research and development on housing construction methods. In addition, banks and credit institutions respectively provided Rls. 11.5 thousand billion and Rls. 40.4 thousand billion in facilities to the construction and housing sector.

Unemployment is amongst the pivotal issues of the 3rd FYDP. The plan proposed the creation of about 3.8 million job opportunities during 1379-1383, an average of 765 thousand new job opportunities per year. A comparison of the quantitative targets set by the 3rd FYDP in respect to job creation, indicates that during the year under review about 100 thousand less job opportunities were created than the projected figure in the Plan (1). In practice the plan's target figures for new employment can not merely be realized through economic growth and investment. Other appropriate measures are necessary and must be put in place to achieve these goals.

Provision of direct incentives to employers aimed at creating productive employment, extending of directed credits by specialized banks for expansion of productive industries, and financing of the Employment Support Fund were amongst the effective steps taken in creating job opportunities in the year under review.

In 1379, GDP on the basis of preliminary data, at constant 1369 prices, grew by 5.1 percent and amounted to Rls. 51,245.0 billion. The value-added for all economic sectors showed positive growth. In both the agricultural and oil sectors of the economy, which had recorded a downturn in the previous year, a marked improvement was recorded which shows a continuing positive trend.

The gross fixed capital formation continued to increase as in the previous year and grew by 9.4 percent this year. Increase in the volume of gross fixed capital formation in machinery for the public sector and in construction for the private sector were the main factors affecting this upward trend.

Private and public consumption expenditures at constant prices respectively increased by 4.8 and 0.3 percent. The percentage share in GDP for overall consumption expenditures i.e. both private and public sectors, showed a 1.6 percent reduction and went from 70.8 percent in 1378 to 69.2 percent in 1379. The per capita income figure stood at Rls. 7,207 thousand, registering a 30.6 percent growth as compared with the previous year.

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(1) The projected figure in the 3rd FYDP for the first year of the plan was 500 thousand job opportunities.