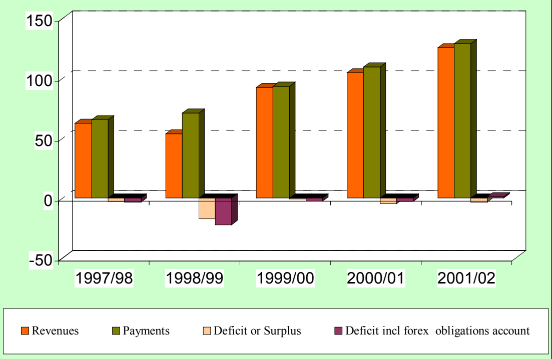
CHAPTER EIGHT

FISCAL POLICY AND PERFORMANCE

The Budget Law for 1380 was designed in a condition that the implementation of policies aimed at increasing social participation, creating employment and providing sustainable economic growth were the main concerns. These objectives were pursued to reduce unemployment, expand human resources and technology and flourish the country's potentials and resources.

Increase in international crude oil prices and improvement in economic indicators in 1379 helped the government to design the 1380 Budget without borrowing from the banking system. Although it was expected that the improving trend in the oil market would continue in 1380, the budget was designed conservatively, projecting crude oil prices at $ 16 per barrel. Moreover, it was determined that crude oil export proceeds in excess of the budgeted figure be deposited into Oil Stabilization Fund (OSF). Therefore, attempts were made to contain the expansionary effects of oil revenues on the government budget. Furthermore, the tax system was reformed in 1380. This was in line with the priority given to production, investment and exports, together with raising tax revenues. The reform included mostly revisions in the tax rates and restructuring of tax organization. Besides the division of tax rates according to legal and real persons[(1)], income tax rates for legal persons were also reduced markedly. To increase tax base rates exemptions and tax brackets, tax threshold raised to Rls. 1,300 thousand for the last two months of 1380 and was determined at Rls. 1,450 thousand for 1381. Increase in tax threshold on heritage, reduction in the cases subject to ex officio assessment, and the replacement of law for discretion are among the other amendments of Direct Tax Law.

Government Fiscal Position
(thousand billion rials)



In addition to the above mentioned reforms, the following measures were adopted and implemented in 1380 to improve the structure of tax system. Based on 3rd FYDP Law, to raise the efficiency of tax system and to centralize all tax-related affairs, State Tax Organization was

(1) Tax rate on salary of government employees who are subject to "unified system of payment to government employees" was determined at 10 percent, after deducting the tax threshold set in the law. In the case of other salaried , upto Rls. 42,000,000, tax rate is 10 percent, after considering tax threshold and for the amounts exceeding, the rate shall be in accordance with the rates set under Article 131.

established as a public institution under the supervision of the Ministry of Economic Affairs and Finance. Moreover, the Large Tax-payers Bureau was also established, through approval of the MPO in 1380. Expansion of cross-country mechanized tax information system aimed at increasing tax bases and finding new tax resources was among other measures adopted in the review period.

GOVERNMENT FISCAL POSITION (billion rials)

	1378	1379	1380
Revenues	**92,315.7**	**104,640.8**	**125,479.5**
Oil	44,487.6	59,448.5	74,957.1
Taxes	25,831.3	32,842.1	38,796.6
Other	21,996.8	12,350.2	11,725.7
Expenditures	**93,242.9**	**109,407.1**	**128,859.6**
Current	68,219.3	85,847.3	104,772.0
Development	25,023.6	23,559.8	24,087.6
Budget deficit	**927.2**	**4,766.3**	**3,380.1**
Deficit (including changes in the balance of foreign exchange obligations account)	**2,739.8**	**2,985.9**	**1,032.5**
in percent of GDP (at current prices)			
Revenues	**21.5**	**18.4**	**18.9**
Oil	10.4	10.5	11.3
Taxes	6.0	5.8	5.9
Other	5.1	2.2	1.8
Expenditures	**21.7**	**19.3**	**19.4**
Current	15.9	15.1	15.8
Development	5.8	4.1	3.6
Budget deficit	**0.2**	**0.8**	**0.5**
Deficit (including changes in the balance of foreign exchange obligations account)	**0.6**	**0.5**	**0.2**

Revenues

Government general revenues (excluding special revenues) rose by 19.9 percent in 1380 compared with the previous year to reach Rls. 125,479.5 billion. This shows 93.1 percent realization as compared with the approved figure in the budget. Underrealization of tax revenues (by 14.5 percent) and other government revenues (by 33.9 percent) were major factors responsible for the underrealization of government general revenues. The crude oil export revenue was realized by 100 percent, and revenues received from sale of foreign exchange was realized by 106.7 percent, resulting in an excess realization of 4.6 percent in the total oil export revenues.

The composition of government general revenues changed moderately in the review year, in a way that it led to more dependence of government budget on oil revenues. While, the share of oil revenues in the general budget (including revenues received from sale of foreign exchange) rose from 56.8 percent in 1379 to 59.7 percent, the share of tax revenues decreased from 31.4 percent to 30.9 percent and other revenues fell from 11.8 percent in the previous year to 9.3 percent in this year. Increase in the revenues received from foreign exchange sales, which based on 1380 Amended Budget Law substituted for government unrealized budget revenues, was the major factor responsible for rise in the share of oil revenues in government general revenues.

According to 1380 Budget Law, crude oil export revenues was earmarked at Rls. 22,512 billion which remained unchanged in the amended budget law. In the review year, oil revenues realized more than the budgeted figure and the excess foreign exchange revenues resulting from crude export was deposited into the Oil Stabilization Fund (OSF) .

In 1380 Budget Law, the average price of each barrel of crude export was determined at $ 16. According to data released by the Ministry of Petroleum, however, average price of each barrel of crude export reached $ 21.4. Thus, the total revenues received from crude export amounted to $ 16,742.7 million and the average crude oil export was 2,076.3 thousand b/d in 1380.

According to the released data, the revenue received from export of oil products and liquefied gas totaled $ 2,310.1 million, of which $ 587.6 million was related to export of oil products for exchange. Therefore, foreign exchange revenues received from export of crude oil, oil products, gas and liquefied gas totaled $ 19,052.8 million, showing 19.2 percent reduction compared with the previous year.

Non-oil revenues (including tax and other government revenues) grew by 11.8 percent in 1380 to reach Rls. 50,522.4 billion, showing 20 percent underrealization when compared with the approved figure of the budget. During the recent years, the share of non-oil revenues out of total government general revenues has declined, while the share of oil revenues (including revenues received from sale of foreign exchange) has gone up. Therefore, increase in revenues from sale of foreign exchange is the main reason for the rise in the share of oil revenue in the government general budget.

In 1380, the composition of non-oil revenues in the government general budget indicates that the share of tax revenues out of total non-oil revenues increased, while other revenues (including revenues received from government monopolies and ownerships, services and sale of goods, interest on loans and government investment abroad and miscellaneous revenues) declined.

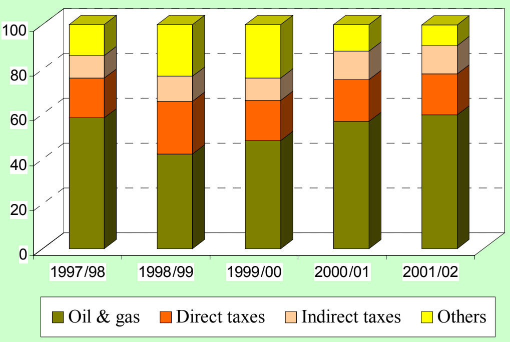
GOVERNMENT GENERAL REVENUES
(excluding special revenues) (billion rials)

			Percentage change		Share (percent)	
	1379	1380	1379	1380	1379	1380
Oil	**59,448.5**	**74,957.1**	**33.6**	**26.1**	**56.8**	**59.7**
Non-oil	**45,192.3**	**50,522.4**	**-5.5**	**11.8**	**43.2**	**40.3**
Tax	32,842.1	38,796.6	27.1	18.1	31.4	30.9
Other	12,350.2	11,725.7	-43.9	-5.1	11.8	9.3
Total	**104,640.8**	**125,479.5**	**13.4**	**19.9**	**100.0**	**100.0**

The ratio of tax revenues to GDP at current prices, as indicator of tax attempt, stood at 5.9 percent, showing a slight increase when compared to the respective ratio in the previous year (5.7 percent). Moreover, the ratio of taxes to government current expenditures equaled 37 percent, showing a reduction as compared with respective figure in1379 (38.3 percent).

The composition of tax revenues in 1380 indicates that 59.2 percent of total tax revenues was received from direct taxes and 40.8 percent from indirect taxes. Receipts from corporate taxes grew by 9.5 percent, compared with the previous year, and amounted to Rls. 12,371.9 billion. However, it shows a 21.5 percent underealization, as compared with the approved figure in the budget. Among the components of corporate taxes, tax on non-public legal persons, with 23.6 percent growth, compared with the previous year, amounted to Rls. 7,904 billion.

Composition of Government Revenues
(percent)



In the review year, revenues received from income tax grew by 27.4 percent to reach Rls. 8,703.7 billion, showing a 9.8 percent underrealization as compared with the previous year. Wealth tax enjoyed a growth of 31.3 percent in 1380 to reach Rls. 1,910.7 billion, while showing only 68.3 percent realization compared with the approved budget.

Among the components of indirect taxes, tax on imports registered 46.4 percent rise to reach Rls. 11,635.3 billion. This indicated 3.2 percent excess realization compared with the approved figure in the budget. Increase in the revenues received from commercial profit (owing to increase in the tariff rates) and order registration fee by 4.3 and 13.4 percent, respectively, compared with the approved figures of the budget is considered as a main reason for the excess realization of indirect taxes.

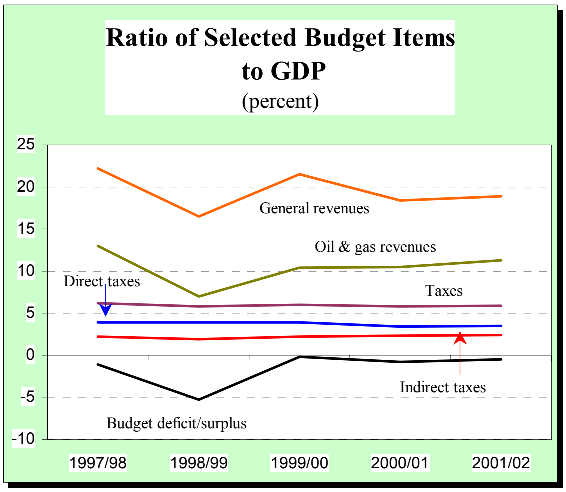
In the review year, receipt from consumption and sales tax fell by 21.4 percent to reach Rls. 4,175.0 billion, and indicated 29.2 percent underrealization as compared with the approved figure of the budget.

Out of total indirect taxes in the review year, 73.6 percent was related to tax on imports and 26.4 percent to consumption and sales tax. Moreover, out of the total tax revenues, 31.9 percent was received from corporate taxes, 22.4 percent from income taxes, 4.9 percent from wealth taxes, 30 percent from import taxes, and 10.8 percent from consumption and sales taxes.

Other government revenues, with 5.1 percent decrease compared with the previous year, amounted to Rls. 11,725.7 billion, showing only 66.1 percent realization compared to the figure approved in the budget. The main reason behind the underrealization of government other revenues was underrealization of revenue received from services and sale of goods by Rls. 3,578.1 billion and miscellaneous revenues by Rls. 2,449.5 billion.

Revenue received from government monopolies and ownerships equaled Rls. 621.1 billion in 1380. This shows 41.2 percent growth when compared with the corresponding figure of the previous year, and 4.4 percent excess realization as compared to the figure approved in the budget.

Revenue received from interest on loans and government investment abroad amounted to Rls. 0.3 billion, showing 100 percent realization as compared with the respective figure of the previous year.



Expenditures

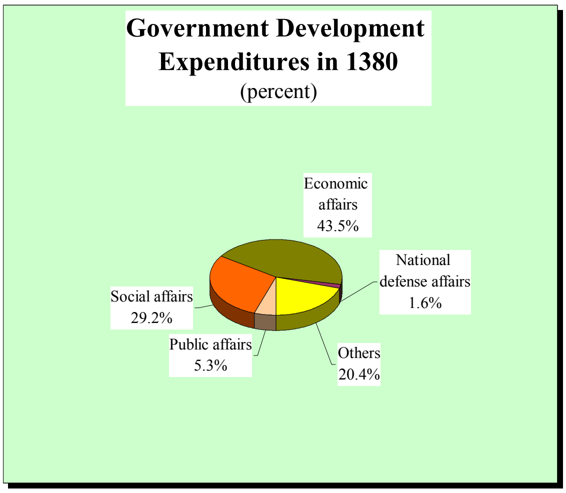
Government general expenditures (excluding special expenditures) amounted to Rls. 128,859.6 billion in 1380, indicating 17.8 percent increase compared with the previous year's figure and 8.7 percent underrealization compared with the figure approved in the budget. In the review year, out of total government expenditures, 81.3 percent was allocated to current and 18.7 percent to development expenditures. Moreover, out of total credits paid, Rls. 95,637.5 billion (74.2 percent) was in the form of national and Rls. 33,222.1 billion (25.8 percent) in the form of provincial credits, showing 15.6 and 24.6 percent rise as compared with the corresponding figures of the previous year.

Current expenditures rose by 22 percent compared with the previous year, to reach Rls. 104,772 billion. This figure indicated 0.2 percent excess realization compared with the figure approved in the budget. Increase in the current expenditures was partly due to the 13 percent rise in the coefficient base of government employees' salaries.

Government subsidy payments amounted to Rls. 9,883.5 billion in 1380, which was earmarked for payments on certain essential goods and services, showing 21.7 percent growth compared with the previous year. Subsidy payments was realized by 90.9 percent when compared with the approved figure (Rls. 10,878.2 billion) in the budget. This figure equaled 9.4 percent of current expenditures and 7.7 percent of government total expenditures.

Out of government current expenditures i.e. Rls. 104,772 billion, 43.8 percent was related to social affairs, 19.8 percent to national defense, 13.6 percent to general affairs and 2.9 percent to economic affairs. Moreover, 19.9 percent of the total current expenditures included miscellaneous expenditures, guaranteed profit and commission, and repayment of loans and debts(1) and prepayments.

Government development expenditures rose by 2.2 percent in 1380 compared to previous year to amount to Rls. 24,087.6 billion, showing 34.2 percent underrealization when compared to the figure approved in the budget. The ratio of government development expenditures to total expenditures equaled 18.7 percent, which indicated a reduction, as compared with the corresponding figure of the previous year (21.5 percent).



According to the 1380 Budget Law, government was authorized to issue up to Rls. 2,400 billion participation papers to speed up the execution of development projects. Revenues from sale of participation papers amounted to Rls. 2,305.3 billion, realizing by 96.1 percent of the figure in the budget. This figure showed 12.5 percent growth when compared with the corresponding figure of the previous year.

Out of total government development expenditures, 43.5 percent was allocated to investment in economic affairs, 29.2 percent in social affairs, 5.3 percent in general affairs and 1.6 percent in national defense affairs. Moreover, the share of miscellaneous expenditures, guaranteed profit and commission, repayment of loans and debts and prepayments and provincial administered funds equaled 20.4 percent.

Budget Deficit and Its Finance

Government budget ran a deficit of Rls. 3,380.1 billion in 1380. Considering payment of Rls. 2,800 billion ($ 1,600 million) for foreign exchange losses of previous years, the outstanding of foreign exchange obligations account fell by Rls. 2,347.6 billion, by the end of 1380. Thus, the adjusted budget deficit was limited to Rls. 1,032.5 billion, including reduction in the outstanding of foreign exchange obligations account. On this basis, the ratio of government general budget deficit to GDP fell down to 0.5 percent in 1380, against 0.8 percent in the previous year. The ratios of adjusted budget deficit to GDP were, respectively, 0.5 and 0.2 percent in 1379 and 1380.

In the review year, the outstanding balance of public sector funds and deposits with the banking system fell dramatically by 87 percent and reached Rls. 1,363.5 billion. On the contrary,

(1) Due to the unavailability of the figures related to the performance of government current and development expenditures in 1380 according to affairs and chapters, the percent realization of total current and development expenditures to the approved figures is generalized to all items.

the outstanding of banking system claims on the public sector grew by 176.5 percent to amount to Rls. 15,671.9 billion. This resulted in the increase of Rls. 14,308.4 billion in the banking system's net claims on the public sector.

BUDGET DEFICIT AND ITS FINANCE (billion rials)

	1378	1379	1380
Government general budget deficit (-) / surplus (+)	**-927.2**	**-4,766.3**	**-3,380.1**
Plus:			
Increase (-) / decrease (+) in the outstanding of foreign exchange obligations account	-1,812.6	1,780.4 (1)	2,347.6 (1)
Increase (-) / decrease (+) in the outstanding of government bonds rewards	-2.8	2.8	0
Adjusted budget deficit	**-2,742.6**	**-2,983.1**	**-1,032.5**
Deficit financing (+) / surplus use (-)	**2,742.6**	**2,983.1**	**1,032.5**
Domestic finance	**2,570.9**	**2,807.4**	**802.9**
Use of Central Bank resources (2)	1,815.4	-1,783.2	-2,347.6
Sales of participation papers	1,884.3	2,049.8	2,305.3
Returns, prepayments and other accounts	640.0	1,287.2	615.8
Principal and interest on loans of public corporations and institutions out of government guaranteed loans (3)	195.5	162.6	135.8
Privatization proceeds	4.2	0.2	93.6
Other	-1,968.5	1,090.8	0
Foreign finance	**171.7**	**175.7**	229.6
Principal of government loans abroad	17.7	0.7	**0.7**
Receipts from foreign facilities	154.0	175.0	228.9

(1) The outstanding (debit) of foreign exchange obligations account was reduced due to the repayment of part of CBI's claims on government.

(2) Includes use of Central Bank's resources for deficit financing of foreign exchange obligations account and rewards on bonds.

(3) The breakdown by interest and principal of loan is not available.

In the review year, the net foreign exchange receipts of the public sector, with 31.3 percent reduction, reached Rls. 13,539 billion. The net monetary expansion due to public sector operations was Rls. 27,847.4 billion, showing 87.2 percent growth compared with the previous year.

Performance of Off-budget Items

In 1380, a total of Rls. 52,445.1 billion was deposited into government general revenue account from the sale of foreign exchange. Total government off-budget revenues equaled Rls. 13,465.3 billion, showing 83.8 percent realization. The expenditures out of government off-budget revenues amounted to Rls. 13,015.3 billion.

It is to be mentioned that, since the end of 1379, the CBI purchased excess foreign exchange as royalty at CD rate to sell at the due time. On this basis, out of Rls. 65,926.2 billion revenues received from sale of foreign exchange in the budget and budgetary notes framework (by Rls. 52,445.1 and 13,481.1 billion, respectively) Rls. 23,710.8 billion (about 36 percent) was realized through sale of royalty to the CBI. This figure amounted to Rls. 24,671.2 billion (47.1 percent of total sale of foreign exchange in the market) in 1379.

The Oil Stabilization Fund

According to Article 60 of the 3rd FYDP Law, the OSF was established to insulate the budget from fluctuations in crude oil prices, to convert oil export proceeds into other reserves, to invest, and to support realization of projected activities during the course of the Plan.

Accordingly, oil revenues in excess of budgeted amount are deposited into an account kept with the CBI, namely OSF. In case, during the 3rd Plan period, the realized crude oil export is less than the projected figures of the budget, the government is authorized to withdraw from OSF account in 3-month intervals and transfer its equivalent in rials to the general revenue account.

The government is authorized to use upto 50 percent of OSF resources to extend facilities to non-public sector, through local banking network and Iranian banks abroad in productive and entrepreneurial projects in manufacturing, mining, agriculture, transportation, and technical and engineering services whose feasibility are approved by the respective ministries.

Utilization of OSF to finance government general budget expenditures is merely allowed in case of a drop in oil export revenues as compared with the approved budget and inability to compensate it from tax or other sources. However, its utilization for financing deficit resulted from government budget non-oil revenues is not authorized.

The executive by-law of Article 60 of the 3rd Plan was designed according to the proposal of the Management and Planning Organization, the Ministry of Economic Affairs and Finance and the Central Bank of Islamic Republic of Iran and was approved by the Cabinet. Selected items of the by-law, and the regulations for extending facilities approved by the OSF Board of Trustee are as follows:

a- A board, comprised of the head of Management and Planning Organization, the Minister of Economic Affairs and Finance, the Governor of the Central Bank and two members selected by the President, is established as "OSF Board of Trustees". The Board's Secretariat is in the Management and Planning Organization.

b- The maximum ceiling of facilities extended to each project is equivalent to the foreign exchange portion of investment of the project.

c- The OSF facilities are extended in foreign exchange and repayment of the principal and accrued interest shall be in foreign exchange.

d- The maximum period of OSF facilities is 8 years, of which 3 years are the maximum grace period.

e- Extending facilities to the projects approved in the framework of "Law for Attraction and Protection of Foreign Investment" (joint ventures) are authorized with the observance of this by-law.

f- The minimum expected rate of return of the project should not be less than the profit rate for financing facilities.

g- The profit rate for OSF facilities was set at LIBOR plus 2 percentage points. 60 percent of the profit is allocated to agent bank and the remainder shall be deposited into the OSF.

INITIAL EXPANSIONARY EFFECTS OF PUBLIC SECTOR OPERATIONS (billion rials)

	1378	1379	1380
Net expansion	**22,626.4**	**14,876.8**	**27,847.4**
Net foreign exchange receipts of public sector	**19,488.2**	**19,696.1**	**13,539.0**
Changes in net banking system claims on public sector	**3,138.2**	**-4,819.3**	**14,308.4**
Changes in balance of banking system claims on public sector	7,140.8	5,668.4	15,671.9
Government (1)	2,873.5	-2,155.7	5,136.0
Public corporations and institutions (2)	4,267.3	7,824.1	10,535.9
Less:			
Changes in the balance of funds & deposits of public sector with the banking system	4,002.6	10,487.7	1,363.5
Changes in balance of deposits of public sector	4,290.0	10,910.6	1,406.0
Changes in balance of LC prepayment of public sector	-287.4	-422.9	-42.5

(1) Includes changes in the deficit of foreign exchange obligations account.

(2) Includes facilities extended by the Central Bank to public corporations for financing foreign exchange losses.

Oil Stabilization Fund (OSF) Performance

Out of total foreign exchange revenues received from crude oil export, $ 12,864 million was deposited into the Treasury to finance budget expenditures in rials. Moreover, in line with the implementation of Article 60 of the 3rd FYDP, and the 1380 Budget Law, the remainder of foreign exchange revenues ($ 1,838.7 million) was deposited into the OSF, after payment of $ 1,600 million for foreign exchange losses due to exchange rate unification in 1372.

PERFORMANCE OF THE OSF ACCOUNT (million dollars)

	1379	1380	Change
Outstanding at the beginning of the year	**0**	**5,943.7**	**5,943.7**
Total deposited amount	**5,943.7**	**2,168.2**	**-3,775.5**
Oil receipts	5,943.7	1,838.7	-4,105.0
Interest accrued to OSF account	0	312.1	312.1
Re-receipt of facilities extended (principal and interest)	0	17.4	17.4
Total withdrawn amount	**0**	**814.1**	**814.1**
According to amended budget law	0	380.9	380.9
Compensating losses incurred from drought	0	274.9	274.9
Facilities utilized under the bank-agency contracts	0	258.3	158.3
Balance at the end of the year	**5,943.7**	**7,297.9**	**1,354.2**

With the inclusion of deposited and withdrawn amounts, the balance of OSF account amounted to $ 7,297.9 million at the end of 1380, showing 22.8 percent growth as compared with that of 1379.