CHAPTER TEN

FISCAL POLICY AND PERFORMANCE

The Budget for 1381 was formulated in the framework of the 3rd Plan without borrowing from the banking system. Design and formulation of 1381 Budget coincided with favorable condition, i.e. relative improvement in economic indices such as GDP and gross fixed capital formation, implementation of government policies in the area of market regulation for goods and services, control of exchange rate fluctuations, reduction in unemployment rate and containment of inflation rate. Moreover, buildup of $ 8 billion in the OSF provided a safe position for budget formulation and compensating the negative effects of exchange rate unification on the budget law.

Excess foreign exchange proceeds from oil export was deposited into the OSF as in 1379 and 1380 according to the mechanism projected in the 3rd Plan Law and the respective amendment. This was to face likely fluctuations of reduction in foreign exchange proceeds from crude oil export in the course of the 3rd Plan and to avoid expansionary effects of these funds on the government budget.

The Management and Planning Organization formulated the Budget Law for 1381 on the basis of Government Finance Statistics Manual (GFSM 2001). Another measure taken in the formulation of the 1381 Budget Law was inclusion of exchange rate unification in budget figures to enhance transparency of budgetary items especially subsidies and eliminate impediments associated with multi exchange rate regime.

On this basis, the Budget Law for 1381 was formulated based on unified exchange rate (US$1/Rls. 7,700) and to prevent price rise of basic goods and services which used to be financed by foreign exchange at official rate, the rial equivalent of the differential of exchange rate at Rls. 7,700 and Rls. 1,750 be provided through allocation of a separate item namely exchange rate differential of subsidized goods.

Since the beginning of 1381, new Direct Tax Law was implemented(1). The amended Law reduced tax rates, increased tax exemptions, and paved the ground for acceptance of real expenses of tax payers. Reform of tax system was done through approval of amended law of 3rd Plan Law and the mechanism envisaged for tax collection from producers and importers (Tax Consolidation Law) and adoption of necessary measures to be implemented since 1382.

In 1381, government revenues including tax revenues and other revenues (excluding special revenues) amounted to Rls. 62,108.6 billion, showing 75.1 percent realization compared to the approved budget and 16.9 percent growth compared with respective figure of the previous year. Of the total revenues, 80.7 percent was received from tax revenues and 19.3 percent from other revenues.

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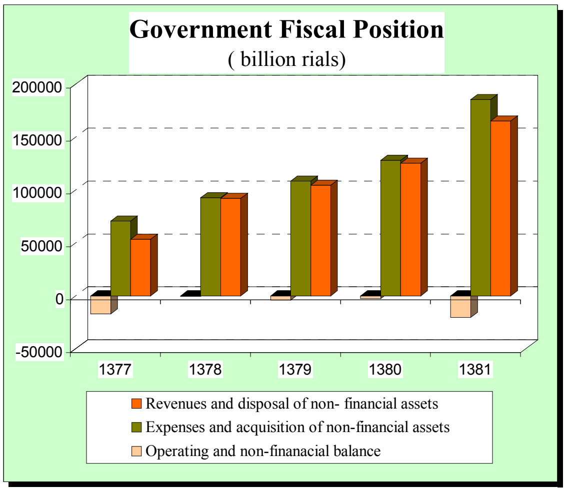
(1) The Direct Tax Law was revised in 1380 and approved by the Parliament in Bahman, 1380.

Implementation of New Classification of Government Finance Statistics

In the first step taken for implementation of GFSM 2001 in Iran, the sum of tax revenues and other revenues is classified under government revenues, and receipts from export of crude oil and gas under disposal of non-financial assets. Moreover, receipts such as receipts from sale of participation papers, principal of government loans abroad, privatization proceeds, foreign financing and OSF utilization, which could create indebtedness or convert the assets are classified under disposal of financial assets. In expense side, the payments referring to current expenditure are classified under expense and those referring to development, infrastructure and capital formation appear under acquisition of non-financial assets. Payments for debt repayment and fulfillment of obligations are classified under acquisition of financial assets.

According to GFSM 2001, differential of revenues and expenses is considered as operating balance, and differential of disposal and acquisition of non-financial assets as net disposal of non-financial assets. The sum of operating balance and net disposal of non-financial assets which has substituted for deficit (surplus) in former classification is financed through net disposal of financial assets (differential of disposal and acquisition of financial assets).

In the review year, expenses grew by 42.6 percent compared to the previous year to reach Rls. 148,297.3 billion, showing 95.3 percent realization compared to the approved budget figure. Therefore, the operating balance ran a deficit of Rls. 86,188.7 billion.



In 1381, receipts from disposal of non-financial assets including sale of oil and oil products and disposal of other non-financial assets grew by 42.5 percent to Rls. 103,101.6 billion, showing 0.5 percent excess realization as compared to the approved figure. Acquisition of non-financial assets (development expenditures) amounted to Rls. 37,212.5 billion, showing 54.5 percent growth compared to previous year and 67.7 percent realization compared to the approved figure. As a result, the net disposal of non-financial assets equaled Rls. 65,889.1 billion.

Considering the performance of revenues and expenses, and disposal and acquisition of non-financial assets, the sum of operating balance and the net disposal of non-financial assets ran a deficit of Rls. 20,299.6 billion, eight times of respective figure in the previous year, however, it was realized by 20 percent less than the approved budget figure. The mentioned figure, namely government budget deficit was totally financed from net disposal of financial assets. The noticeable rise in the sum of operating balance and the net disposal of non-financial assets compared to respective previous figure was largely attributable to exchange rate unification and budget transparency. Disposal of financial assets equaled Rls. 47,937.7 billion and acquisition of financial assets equaled Rls. 27,638.1 billion.

The outstanding balance of foreign exchange obligations account declined by Rls. 215.4 billion for the third consecutive year.

GOVERNMENT FISCAL POSITION			(billion rials)
	1379	1380	1381
Revenues	**44,846.6**	**53,146.1**	**62,108.6**
Taxes	36,585.2	41,786.1	50,141.1
Other	8,261.4	11,360.0	11,967.4
Expenses (current)	**85,061.8**	**103,962.8**	**148,297.3**
Operating balance	**-40,215.2**	**-50,816.7**	**-86,188.7**
Disposal of non-financial assets	59,794.2	72,333.4	103,101.6
Acquisition of non-financial assets (development expenditures)	23,559.8	24,087.6	37,212.5
Net disposal of non-financial assets	**36,234.4**	**48,245.8**	**65,889.1**
Operating and non-financial balance	**-3,980.8**	**-2,570.9**	**-20,299.6**
in percent of GDP			
Revenues	**7.8**	**8.0**	**6.7**
Taxes	6.3	6.3	5.5
Other	1.4	1.7	1.3
Expenses (current)	**14.8**	**15.7**	**16.1**
Operating balance	**-7.0**	**-7.7**	**-9.4**
Disposal of non-financial assets	10.4	10.9	11.2
Acquisition of non-financial assets (development expenditures)	4.1	3.6	4.0
Net disposal of non-financial assets	**6.3**	**7.3**	**7.1**
Operating and non-financial balance	**-0.7**	**-0.4**	**-2.2**

Revenues

In 1381, tax revenues including direct and indirect taxes(1) enjoyed 20 percent growth to reach Rls. 50,141.1 billion, showing 80.3 percent realization compared to the approved budget. The ratio of tax revenues to GDP at current prices was 5.5 percent and to expenses 33.8 percent.

Out of total government tax revenues, 51.2 percent was received from direct and 48.8 percent from indirect taxes. Amendment of Direct Tax Law and sharp decline in income tax rates and wealth tax, effective since the beginning of 1381, reduced the share of direct taxes.

Among the constituents of direct taxes, corporate tax (public and non-public corporations) went up by 19.3 percent, and recorded 24.4 percent underrealization. This was principally due to the underrealization of tax on public corporations.

Despite noticeable decline in tax rates, receipt from income tax including salary, professions, real estate, etc., declined mainly by 5.2 percent and recorded 17.6 percent underrealization as compared to the approved budget. Wealth tax surged markedly by 38.4 percent compared to the previous year, showing 35.6 percent underrealization compared to the approved budget.

Among the constituents of indirect taxes, tax on import and tax on goods and services surged by 38.5 and 16.3 percent and showed 75.3 and 115.6 percent realization compared to approved budget, respectively. The main reason for the rise in import tax was increase in commercial profit and customs duties which in turn was due to the rise in the value of import. It should be mentioned that, the approved figure for commercial profit in the Budget Law for 1381 was three times the approved figure in the previous year. This was attributable to the transfer of

(1) Classification of taxes as direct and indirect does not exist in GFSM 2001. While, due to the similarity of both previous and new classifications, it has remained unchanged.

automobile fixed tax from “consumption and sales tax” to this tax group and expectations for increase in tax on imports as a result of replacement of non-tariff barriers with tariffs. Increase in indirect tax on some goods such as transfer of mobile subscription, beverages and imported steel raised consumption and sales tax.

Among the constituents of government other revenues, revenues received from government ownership and from finings and losses surged markedly, in turn revenues received from services and sale of goods and also miscellaneous revenues declined.

Revenues received from government ownership went up as compared with the previous year. This was principally attributable to the significant rise in “others” subgroup, despite a sharp decline of 43.8 percent in “public corporations’ dividends” subgroup.

GENERAL BUDGET RESOURCES (excluding special receipts) (billion rials)

				Percentage change		Share (percent)	
	1379	1380	1381	1380	1381	1380	1381
Revenues	44,846.6	53,146.1	62,108.6	18.5	16.9	41.2	29.1
Taxes	36,585.2	41,786.1	50,141.1	14.2	20.0	32.4	23.5
Other	8,261.4	11,360.0	11,967.4	37.5	5.3	8.8	5.6
Disposal of non-financial assets	59,794.2	72,333.4	103,101.6	21.0	42.5	56.1	48.4
Disposal of financial assets	4,766.3	3,380.1	47,937.7	-29.1	▣	2.6	22.5
Total	**109,407.1**	**128,859.6**	**213,147.9**	**17.8**	**65.4**	**100.0**	**100.0**

Expenses

Out of total government expenses, 77.2 percent was related to national and 22.8 percent to provincial expenses. The ratio of the performance of these two payments to their approved figures was 95.7 and 93.8 percent, respectively.

Increase in expenses was principally attributable to the rise in employee’s salary, increase in subsidy of basic goods, inclusion of a separate item as “exchange rate differential of subsidized goods”, and payments related to natural disasters.

Besides “exchange rate differential of subsidized goods” which was realized by Rls. 23,575.3 billion, a total of Rls. 13,152.5 billion was also paid by the Organization for Support of Consumers and Producers and the respective organizations, up by 25.6 percent. Of the total subsidy paid, 89.3 percent was paid for basic goods and services and the remainder for chemical fertilizer, seed and pesticide, and purchase of pharmaceuticals and powdered milk.

The major part of subsidy paid on basic goods and services by 76.5 percent was paid by the State Grain Organization for purchase of wheat from farmers, showing a significant rise of 47.5 percent compared to the previous year.

Operating Balance

In 1381, with Rls. 62,108.6 billion revenues and Rls. 148,297.3 billion expenses, operating balance ran a deficit of Rls. 86,188.7 billion, up by 69.6 percent compared to the previous year. This growth was 18.1 percent more than the figure projected in the budget. The increase in operating balance as compared to the previous year was underpinned by the expenses resulting from exchange rate unification, and as compared to approved budget figure it was related to underrealization of revenues.

Disposal and Acquisition of Non-financial Assets

Of the total disposal of non-financial assets, Rls. 102,553.4 billion (99.5 percent) was deposited into the Treasury from sale of oil and Rls. 548.2 billion (0.5 percent) from sale of government buildings and establishments, cession of lands, sale of machinery and equipment and other disposal of non-financial assets.

Receipts from sale of crude oil including differential of sale of foreign exchange proceeds from oil export grew over 40.4 percent compared to the previous year, indicating 2.5 percent excess realization compared to the approved figure. This excess realization resulted from high performance of conversion rate of foreign exchange proceeds from oil export compared to the projected figure in the approved budget.

Of the total acquisition of non-financial assets payments, 78.4 percent was paid for acquisition of national and 21.6 percent for acquisition of provincial non-financial assets. The ratio of the performance of these two payments items to the figures approved in the budget was 64.5 and 82.3 percent, respectively.

GENERAL BUDGET USES OF FUNDS (excluding special payments) (billion rials)

				Percentage change		Share (percent)	
	1379	1380	1381	1380	1381	1380	1381
Expenses (current)	85,061.8	103,962.8	148,297.3	22.2	42.6	80.7	69.6
Acquisition of non-financial assets	23,559.8	24,087.6	37,212.5	2.2	54.5	18.7	17.5
Acquisition of financial assets	785.5	809.2	27,638.1	3.0	⊡	0.6	13.0
Total	**109,407.1**	**128,859.6**	**213,147.9**	**17.8**	**65.4**	**100.0**	**100.0**

Operating and Non-financial Balance

The sum of operating balance and the net disposal of non-financial assets (budget deficit in the former classification) ran a deficit of Rls. 20,299.6 billion. The dramatic rise in budget deficit was largely attributable to the exchange rate unification in calculating expense and acquisition of non-financial assets. The mentioned deficit was mainly financed through withdrawal from the OSF, privatization proceeds, sale of participation papers and unspent cash carried over from previous years.

In the review year, the ratio of operating and non-financial balance deficit to GDP went up markedly from 0.4 percent in 1380 to 2.2 percent in 1381.

Disposal and Acquisition of Financial Assets

In 1381, disposal of financial assets including foreign and domestic financing was realized by 87.1 percent compared to the approved budget to reach Rls. 47,937.7 billion. This remarkable rise was basically owing to increase in domestic financing, so that 99.4 percent of disposal of financial assets was out of domestic financing and 0.6 percent out of foreign financing.

In the review year, domestic financing, including sale of participation papers, privatization proceeds, receipt of principal of government loans, unspent cash carried over from previous years and OSF utilization surged markedly, among which OSF utilization and privatization proceeds were the major factors responsible for increase in domestic financing. Of the total OSF utilization amount, Rls. 16,626 billion ($ 2.1 billion) was allocated to provision of rial expenses and Rls. 19,250 billion ($ 2.5 billion) to repayment of government external debts. In fact, 75.3 percent of domestic financing was provided through OSF utilization. Sale of government participation papers with 8.4 percent increase comprised 5.2 percent of disposal of financial assets.

In the review year, Rls. 8,364 billion of public corporations' shares were transferred, showing 55.8 percent realization compared to the approved figure. Of this amount, Rls. 7,306.7 billion was paid to government for repayment of its indebtedness to Social Security Organization, State Retirement Fund, Astane Ghods Razavi and the Reserve Fund for the Ministry of Education employees and Rls.1,057.3 billion (17.6 percent realization) was deposited into the Treasury. Notwithstanding a marked rise in transfer of public corporations' shares as compared with the previous year, certain factors such as non-formation of all specialized holding companies, share pricing impediments, incongruity between the Ministries and privatization programs, and lack of a comprehensive program for restructuring transferable public corporations led to a low realization of the projected figure .

According to the report released by the Privatization Organization, Rls. 3,131.1 billion of public corporations' shares were sold in 1381. Of this figure, 60.5 percent was sold in the stock exchange and 39.5 percent was in the form of tender.

Acquisition of financial assets grew markedly to Rls. 27,638.1 billion, showing 93.3 percent realization compared to approved budget. This was principally due to the exchange rate unification. The great portion of this amount, i.e., Rls. 19,250 billion ($ 2.5 billion) was earmarked for the repayment of principal of foreign facilities. Moreover, Rls. 8,388.1 billion was paid for purchase of public corporations' shares, repayment of principal of participation papers and payment of Hadj pilgrimage obligations.

Considering disposal and acquisition of financial assets figures, the net disposal of financial assets with a remarkable rise and 79.9 percent realization reached Rls. 20,299.6 billion which financed operating and non-financial balance deficit.

OPERATING AND NON-FINANCIAL BALANCE AND NET DISPOSAL OF FINANCIAL ASSETS

(billion rials)

	1379	1380	1381
Deficit (-) / surplus (+) in operating and non-financial balance	**-3,980.8**	**-2,570.9**	**-20,299.6**
Net disposal of financial assets	**3,980.8**	**2,570.9**	**20,299.6**
Disposal of financial assets (adjusted) (1)	**6,549.5**	**5,727.7**	**48,153.1**
Foreign financing	**175.7**	**229.6**	**287.4**
Receipts from World Bank facilities	175.0	228.9	247.7
Receipts from Islamic Development Bank aids	0	0	36.4
Receipt of principal of government loans abroad	0.7	0.7	3.3
Domestic financing	**6,373.8**	**5,498.1**	**47,865.7**
Borrowing from banking system	0	0	0
Sale of participation papers	2,049.8	2,305.3	2,498.1
Privatization proceeds	0.2	93.6	8,364.0
Note 5, Budget Law for 1381	0	0	7,306.7
Article 19, 3rd Plan Law	0.2	93.6	1,057.3
Receipt of principal of government domestic loans	162.6	135.8	128.2
Unspent cash carried over from previous years	1,287.2	615.8	784.0
OSF utilization	0	0	35,876.0
Note 21, Budget Law for 1381	0	0	16,626.0
Repayment of foreign facilities	0	0	19,250.0
Others	2,874.0	2,347.6	215.4
Acquisition of financial assets (adjusted)(1)	**2,568.7**	**3,156.8**	**27,853.3**
Repayment of foreign facilities	0	0	19,250.0
Reduction in foreign exchange obligations account (2)	1,780.4	2,347.6	215.4
Reduction in the account of rewards on bonds	2.8	0	0
Others	785.5	809.2	8,388.1

(1) Includes changes in the balance of foreign exchange obligations account and rewards on bonds account.

(2) The outstanding (debit) of this account has been reduced due to the repayment of part of CBI's claims on government in recent years.

Performance of Off-budget Items

In 1381, a total of Rls. 19,798.8 billion as off-budget item was paid, Rls. 19,092.5 billion of which was allocated for implementation of development projects by the Treasury, and Rls. 706.3 billion was deposited as stock in banking accounts of the Treasury General.

Privatization

Reorganization of state owned enterprises (SOEs) and transfer of their shares and management was formulated in the 3rd Plan Law as the first comprehensive package for implementation of privatization plan.

According to the 3rd Plan Law, Privatization Organization was introduced as a holding company. It was authorized, as an agent of specialized holding companies, to transfer shares belong to it, and the shares of companies affiliated to the said specialized holding companies.

According to the 3rd Plan Law, specialized holding companies participate in the general assemblies of SOEs as representatives of shareholders. On this basis, SOEs are separated from the government and included within the specialized holding company.

Of the introduced total specialized holding companies 38 companies lack affiliated companies and 32 companies hold affiliated companies. The total number of affiliated companies is 915 companies.

According to the 3rd Plan Law, the mechanism for privatization of SOEs is determined as follows:

- SOEs are reorganized in the framework of specialized holding companies.

- The High Commission of Divestiture studies the list of transferable corporations, their liquidation, merger, timing and way of sale as determined by the relevant ministry and submits to the Cabinet for approval.

- After the approval of the mentioned list by the Cabinet, the mentioned corporations are not subject to the general regulations governing SOEs since the time of the approval and are administered in the framework of commerce law.

- The specialized holding company restructures affiliated SOEs if deemed necessary, and after approval of the base price by the Ministry of Economic Affairs and Finance, submits the required documents and information to the Privatization Organization.

- The Privatization Organization is vested with the authority of selling by the specialized holding company.

- Shares selling announcement including amount of preferential shares to be sold to workers, size of the corporation, selling mechanism, amount of shares to be transferred and transferring priorities is published in journals.

- The Privatization Organization renders appropriate discounts against purchasers' obligations in certain cases.

- 50 percent of the revenue received from sale of shares is allocated to the relevant specialized holding company for payment of saleable corporations indebtedness, restructure of corporations for divestiture, and 50 percent to the Treasury.

- The High Commission of Divestiture issues the required permit for installment sale of shares if deems necessary.

- If the shares are not sold, the Privatization Organization reports the details to the High Commission of Divestiture in six months and takes measures as decreed by the commission.