CHAPTER ELEVEN

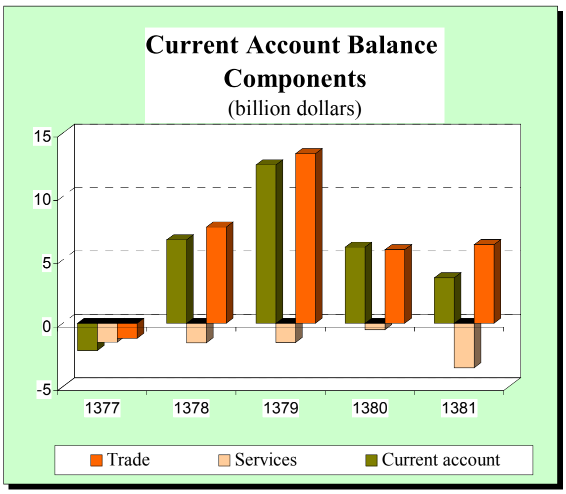
FOREIGN EXCHANGE AND TRADE POLICY

External sector of the economy faced extensive policy changes and deregulation in 1381. Successful implementation of exchange rate unification and continued structural reform in foreign trade regime were among the salient achievements in this sector. These could be evident in the significant growth of non-oil exports and imports in the review year. In order to facilitate this process, along with implementation of exchange rate unification policy and establishment of foreign exchange interbank market, the managed float exchange rate regime was adopted. All these measures taken in tandem with effective use of the Oil Stabilization Fund (OSF) caused the external sector to enjoy a relative stability in the review year.

Balance of Payments Developments

International oil market developments together with gradual implementation of new foreign trade regulations, which were in line with the targets set in the 3rd Plan, affected the balance of payments in 1381. Foreign exchange receipts went up by 18.1 percent, basically attributable to the price rise and amount of export of oil and gas. The composition of oil export basket in 1381 included $ 18,702 million crude oil, $ 3,204 million oil products, liquefied and natural gas, and $ 1,060 million oil and liquefied gas exports related to repayment of buy-back agreements.

Adjustment in the external laws and regulations, providing exporters with various facilities granting them more free hand in managing foreign exchange resources and revenues, extending facilities in rial and foreign exchange to foreign trade sector, elimination of LC prepayment requirement, exemption of exports from taxes and levies, allocation of rewards and export subsidies, and creation of stability in foreign exchange market eased foreign trade process and promoted non-oil exports. This led to a rise of 15.5 percent in non-oil exports from $ 4,565 million in 1380 to $ 5,271 million in 1381. The above-mentioned figures include non-customs exports in addition to customs exports, such as exports of electricity, buoys, scrap oil tankers and estimates of smuggled exports. Total imports went up by 21.6 percent to $ 22,036 million against $ 18,129 million in 1380. Thus, trade balance including oil exports enjoyed $ 6,201 million surplus, up by 7.4 percent compared with the previous year.



Receipts and payments of services account in 1381 equaled $ 5,025 and 8,528 million, respectively(1). In receipts side, freight and insurance and tourism (travel) with $ 1,316 and 1,607 million, made up 58.2 percent of foreign exchange receipts in services account. In payments side, freight and insurance, tourism (travel) and investment income with $ 434, 3,990 and 1,082 million, accounted for 64.6 percent of foreign exchange payments of this sector. Thus, the balance of services account ran a noticeable deficit of $ 3,503 million in 1381. Transfers account of BOP enjoyed $ 887 million surplus, basically attributable to the remittance of Iranians residing aboard. The balance of current account enjoyed $ 3,585 million surplus, which was utilized for repayment of external debts, increase in the OSF account and increase in the CBI's foreign assets.

Capital account showed $ 2,534 million surplus. Government long-term account in this year faced $ 3,079 million net debt owing to the build up of new debts in 1381, mostly resulted from sale of Euro bonds, obligations from buy-back contracts, oil prefinance, and finance contracts. A sum of $ 1,061 million was allocated to the repayment of buy-back contracts' obligations and $ 2,028 million new obligations were made out of these contracts. Government short-term account ran a deficit of $ 64 million, owing to the deficit of clearing accounts. Banks' net foreign assets went up by $ 306 million and debts related to their LCs fell by $ 575 million. The CBI's foreign assets and the OSF account rose by $ 3,883 and 784 million, respectively, leading to a $ 4,667 million surplus in the overall balance of BOP.

Foreign Exchange Obligations

Foreign exchange obligations went up by 24.9 percent, from $ 21.8 billion (including interest and contingent obligations) to $ 27.2 billion at the end of 1381(2). The composition of contingent obligations and external debts remained relatively unchanged, despite the rise in foreign exchange obligations in 1381. The share of contingent obligations fell from 63.2 percent at the end of 1380 to 61.6 percent at the end of 1381. During the course of this year, external debts amounted to $ 9,250 million against $ 7,214 million in 1380, up by 28.2 percent. In 1381, short-term debts fell by $ 575 million, while long and medium-term debts rose by $ 2,611 million, raising external debts to $ 9,250 million. Sale of Euro-bonds by $ 1,066 million contributed greatly to the rise in long-term debts. The share of short-term debts in total external debts according to initial maturity was reduced to 22.5 percent at the end of 1381, against 36.8 percent at the end of 1380. This indicated a high flexibility in external debt management.

COMPOSITION OF FOREIGN OBLIGATIONS

(million dollars)

	1380	1381	Percentage change
Contingent obligations	13,750	16,754	21.8
External debts	7,214	9,250	28.2
Interest	803	1,178	46.7
Total obligations	**21,767**	**27,181**	**24.9**

Foreign Exchange Balance of the Banking System

Current foreign exchange receipts of the banking system amounted to $ 23,266 million in 1381, up by 9.6 percent. This was basically due to the increase in oil and gas export revenues. Current foreign exchange payments fell by 3.8 percent to reach $ 11,645 million. Thus, the net current account of foreign exchange balance ran a surplus of $ 11.6 billion.

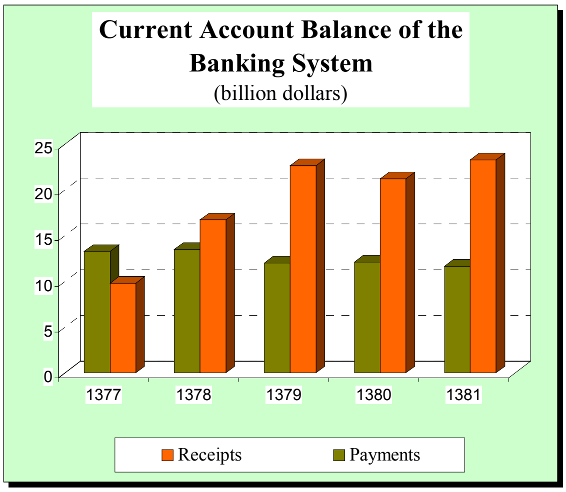
(1) The data coverage for services account (receipts and payments) was extended markedly.

(2) According to Article 85, 3rd FYDP Law, the ceiling of authorized obligations (net, after deducting CBI's foreign exchange reserves), excluding buy-back contracts is $ 25 billion.

SUMMARY OF FOREIGN EXCHANGE BALANCE OF THE BANKING SYSTEM

(million dollars)

	1379	1380	1381
Net current account	10,645	9,124	11,621
Net capital account	-145	3,673	2,483
Unclassified items	-4,347	-8,769	-5,046
Overall balance	**6,153**	**4,028**	**9,058**

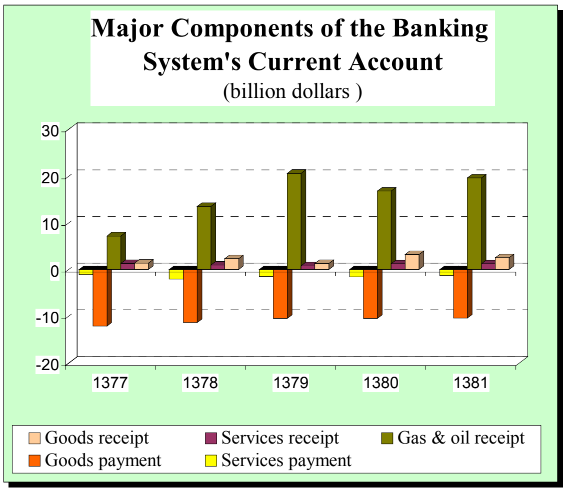


In the review year, capital receipts surged by 49.9 percent to $ 28,189 million, owing largely to the return of principal of loan and capital by $ 25,024 million. Capital payments with 69.9 percent rise amounted to $ 25,706 million, which was mainly used for investment and extending of facility. Hence, net capital account registered $ 2,483 million surplus.

Considering the figures related to net current and capital account and adjustments in exchange rate and unregistered transactions, overall foreign exchange balance of the banking system ran a surplus of $ 9.1 billion.

Current Receipts

In 1381, current foreign exchange receipts, with $ 2 billion rise amounted to $ 23,266 million. This was basically due to rise in oil proceeds. High oil prices in international markets and rise in crude exports raised foreign exchange earnings by 17.2 percent to $ 19,405 million. The share of foreign exchange receipts from oil exports out of total current foreign exchange receipts increased from 78 percent in 1380 to 83.4 percent in 1381.



Foreign exchange purchased from non-oil exports declined by 24 percent compared to the year before, and was limited to $ 2,459 million, which constituted 46.7 percent of total non-oil exports in 1381. Foreign exchange receipts for services items fell by 4.2 percent in 1381 to $ 1,181 million, from $ 1,233 million in 1380. This was largely due to the reduction in foreign exchange receipts of the public sector and reduction in the interest received.

Current Payments

In 1381, current foreign exchange payments of the banking system fell by 3.8 percent compared with the previous year and was limited to $ 11,645 million, 89 percent of which was related to import of goods. Foreign exchange payments for imports of goods by the public sector fell by 39 percent to $ 3,145 million in 1381, against $ 5,159

SUMMARY OF CURRENT ACCOUNT BALANCE OF THE BANKING SYSTEM

(million dollars)

	1379	1380	1381
Current receipts	22,649	21,224	23,266
Current payments	12,004	12,100	11,645
Net current account	**10,645**	**9,124**	**11,621**

million in 1380. The share of non-public sector in these payments rose from 50.7 percent in 1380 to 69.7 percent in 1381. In the review year, current payments for services fell by 22 percent and was limited to $ 1,280 million, owing to reduction in the public sector payments and interest paid.

Foreign Exchange and Trade Policies

Foreign exchange and trade policies underwent reforms in 1381, aiming at easing trade and deregulating the external sector. Sufficient foreign exchange reserves in the OSF account resulted in the successful implementation of exchange rate unification and announcement of managed float as foreign exchange regime. In this context, all foreign exchange regulations in the areas of transaction of goods, foreign exchange used in services transactions, and banking operations were adjusted in compliance with the new exchange regime.

Foreign Exchange Policies

In order to expand and facilitate foreign exchange transactions, transactions on foreign exchange certificate of deposit in the TSE was cancelled and currencies were transacted in interbank market at reference rate. According to new arrangements, all banks in addition to the CBI, can transact foreign exchange in the mentioned market.

In order to regulate foreign exchange operations of banks and also banking units in the free-trade and industrial zones and branches of Iranian banks abroad, foreign exchange regulations pertaining to foreign exchange transactions and import of goods and services through opening LCs, bill and draft registration were formulated. According to these regulations, purchase of foreign exchanges transfers through international banking system was authorized with no restriction: Purchase of notes should be done through observing anti-money laundering regulations. Moreover, banks were authorized to sell foreign exchange provided that the applicant's identity was clear and banking instruments are used. Selling foreign exchange in cash was also authorized, observing banks' regulations. Moreover, import of goods and services and freight to free trade zones were excluded from general export and import regulations of the main land and were subject to relaxation of regulations for these zones.

To pave the ground for foreign exchange transactions and to reduce the demand in the parallel market, establishment and operation of exchange bureaus (except in free trade industrial zones) was authorized. Moreover, the by-law pertaining to services foreign exchange transactions in various fields (transportation, insurance, inspection of goods, travel, university students and patients) was announced to banks.

In order to attract foreign investment and facilitate financial transactions, Foreign Investment Promotion and Protection Act was approved. According to the new Act, the ceiling of foreign investors' partnership in each economic sector was set at 25 percent and in each field of activity at 35 percent (except for oil sector which was exempted from the mentioned ceilings).

The OSF Board of Trustees facilitated extending of loans to export-productive projects, through revising the respective rules and regulations. Increase in demand for OSF resources has required the CBI to meet the needs of agent banks without new quota allocation.

Foreign Exchange Interbank Market, Purposes and Functions

One of the most important achievements of country's economic system in 1381 was the implementation of exchange rate unification and establishment of a unified market for foreign currencies, namely foreign exchange interbank market. This market is a wholesale market for foreign exchange transactions wherein supply and demand determine rial parity. With the establishment of this market, foreign currencies were transacted in the banking system rather than in stock exchange. The aim of establishment of this market was to create a single institution for all permitted foreign exchange transactions and to pave the ground for the provision of foreign exchange required by all economic sectors under equal circumstances. Another function of this market is the elimination of distortions in the relative prices resulted from the application of multiple exchange rate regime and creation of an instrument for supervision in policy making in this sector. Public commercial and specialized banks as well as the CBI are active in this market and have full authority to determine buying and selling rates of foreign currency. CBI's contribution to this market is aimed at improving composition of rial and foreign exchange reserves and compensating for unfavorable fluctuations in parity rate. This bank could transact foreign exchange at its own account, while its interference should be in line with observing and maintaining the role of market in pricing. Authorized exchange beaureus could, in turn, increase liquidity and market efficiency as all economic agents could benefit from the service of this market.

Moreover, since the fourth quarter of 1381, secondary interbank market was established in Kish free trade zone to attract foreign exchange transactions of overseas markets into the mainland.

A sum of $ 10,953 million was exchanged both in the main and secondary markets, $ 1,493 million of which was exchanged in secondary market. The CBI made up 86 percent of the total transactions.

Export Policies

To facilitate foreign trade and to deregulate non-oil export process, exports of all goods and services were exempted from foreign exchange surrender requirement. As a result, exporters were authorized to manage their foreign exchange resources.

In order to enhance private sector contribution to economic activities and promote non-oil exports, private export promotion funds were established. Moreover, certain measures were taken to compensate for foreign exchange losses incurred by exporters in view of exchange rate fluctuations, dramatic drop in export price of goods in international markets and financing of export rewards, during the course of 1379-81.

Import Policies

To improve coordination of foreign exchange and trade policies, customs duties and commercial profit were modified according to new exchange rate and import policies. Moreover, import of spare parts and production machinery was authorized by the private sector through short-term credit lines (refinance). In addition, import of assembly line machinery was exempted from order registration fee and the list of the mentioned tariffs was announced. In order to facilitate import of authorized goods and combat smuggling of goods, the list of importable goods not using foreign exchange transfer, with order registration, was announced.

Foreign Trade

In compliance with the objectives of the 3rd Plan focusing on export promotion, easing of foreign trade promotion policies became the cornerstone of the developments in this sector. Extensive deregulation and reduction in transactions expenses and institutionalization of foreign exchange market improved foreign trade remarkably, so that the value of non-oil customs exports went up by 9.1 percent compared to 1380 to $ 4,608 million. Considering 17.6 percent reduction in the weight of exports, the value per ton of exported goods increased noticeably by 32.4 percent to $ 345.

The cif value of imported goods rose by 26.4 percent to $ 22,275 million, due largely to the improvement in foreign exchange proceeds, and easing of import regulations. The value of imports (adjusted) after deducting import order registration fee grew by 34.1 percent from $ 16,228 million in 1380 to $ 21,761 million in 1381. Despite negligible change in the weight of imported goods, accelerated growth of the value of imports led to the rise in the value per ton of imported goods by 36.8 percent to $ 808. Global economic boom was somewhat responsible for this rise.

FOREIGN TRADE
(excluding oil, gas and electricity)

						Percentage change		Share (percent)	
	1377	1378	1379	1380	1381	1380	1381	1380	1381
Amount (million $)									
1. Imports	14,323	12,683	14,347	17,626	22,275	22.9	26.4	86.2	84.5
2.Adjusted imports (1)	13,708	11,972	13,187	16,228	21,761	23.1	34.1	79.3	82.5
3. Exports	3,013	3,362	3,763	4,224	4,608	12.3	9.1	20.7	17.5
Deficit (3-2)	-10,695	-8,610	-9,424	-12,004	-17,153	27.4	42.9	-58.7	-65.0
Total (3+2)	**16,721**	**15,334**	**16,950**	**20,452**	**26,369**	**20.7**	**28.9**	**100.0**	**100.0**
Weight (thousand tons)									
1. Imports	16,297	21,549	25,980	27,464	26,927	5.7	-2.0	62.9	66.8
2. Exports	14,460	17,567	14,281	16,214	13,362	13.5	-17.6	37.1	33.2
Total (1+2)	**30,757**	**39,116**	**40,261**	**43,678**	**40,289**	**8.5**	**-7.8**	**100.0**	**100.0**

(1) In foreign trade statistics, the value of imports includes value of goods plus order registration fee, therefore, order registration fees have been deducted from the value of imports and have come under adjusted imports.

Imports

The composition of imported goods shows that despite 18.7 percent growth in import of raw materials and intermediate goods, the share of imports of these goods declined from 46.7 percent in 1380 to 43.8 percent in 1381. The share of capital goods increased virtually by the same amount, and the share of consumer goods remained unchanged.

COMPOSITION OF IMPORTS BY USE (million dollars)

			Percentage change		Share (percent)	
	1380	1381	1380	1381	1380	1381
Raw materials and intermediate goods	8,228	9,766	11.2	18.7	46.7	43.8
Capital goods	7,127	9,668	47.4	35.6	40.4	43.4
Consumer goods	2,270	2,842	7.5	25.2	12.9	12.8
Total	**17,626**	**22,275**	**22.9**	**26.4**	**100.0**	**100.0**
Imports (Adjusted)	**16,228**	**21,761**	**23.1**	**34.1**		

Classification of imports according to international classification of goods indicates that import of machinery and transportation vehicles with a share of 45.9 percent in the total imports had the highest share in 1381. The share of import of basic manufactured goods(1) declined from 18.8 percent in 1380 to 14.5 percent in 1381.

IMPORTS BASED ON THE INTERNATIONAL CLASSIFICATION OF GOODS

(million dollars)

			Percentage change		Share (percent)	
	1380	1381	1380	1381	1380	1381
Machinery and transportation vehicles	7,565	10,221	46.2	35.1	42.9	45.9
Goods classified according to their compositions	3,319	3,220	4.2	-3.0	18.8	14.5
Foodstuff and live animals	2,106	1,522	6.5	-27.7	11.9	6.8
Chemical materials	2,384	2,580	17.6	8.2	13.5	11.6
Others	2,252	4,732	13.4	110.1	12.9	21.2
Total	**17,625**	**22,275**	**22.9**	**26.4**	**100.0**	**100.0**
Imports (Adjusted)	**16,228**	**21,761**	**23.1**	**34.1**		

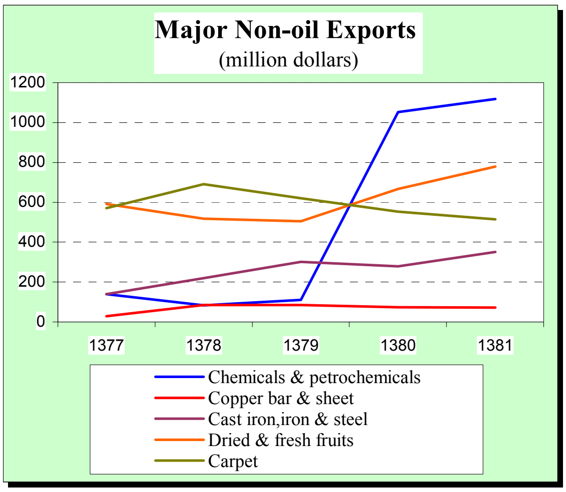
Imports by countries shows that Germany, UAE, Switzerland, Italy and France with 47.7 percent share in total imports were the top 5 exporting countries to Iran in 1381. Value of imports from Switzerland, Germany and Singapore, respectively showed the highest growths. Imports from Canada with 48.1 percent decline recorded the highest reduction.

Imports by group of countries indicates that imports from European Union, with 38.7 percent growth and 40.8 percent share in total imports amounted to $ 9,097 million. Imports from ESCAP countries grew by 5.1 percent to $ 6,829 million. These two groups of countries accounted for 71.5 percent of total imports. Imports by continent is indicative of the high share of imports from Asia and Europe by 91.5 percent to amount to $ 20,392 million.

Non-oil Exports

In 1381, a total of 13,362 thousand tons of non-oil goods valuing at $ 4,608 million were exported, showing 17.6 percent reduction in weight and 9.1 percent rise in value.

Classification of non-oil exports by uses indicates reduction in the share of exports of consumer goods from 53.9 percent to 51.4 percent and increase in the share of exports of raw materials and intermediate goods from 42.5 percent to 44.7 percent. In this year, the share of exports of capital goods remained unchanged.



COMPOSITION OF EXPORTS ACCORDING TO USES
(excluding oil, gas and electricity)

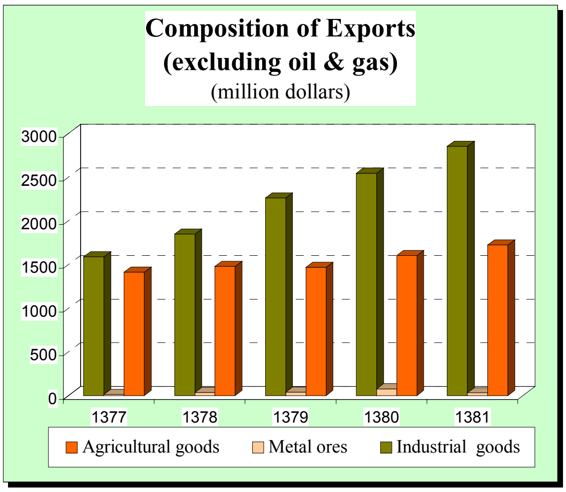
(million dollars)

			Percentage change		Share (percent)	
	1380	1381	1380	1381	1380	1381
Raw materials and intermediate goods	1,794	2,059	10.5	14.8	42.5	44.7
Capital goods	155	178	11.2	15.3	3.7	3.9
Consumer goods	2,275	2,371	13.7	4.2	53.8	51.4
Total	**4,224**	**4,608**	**12.3**	**9.1**	**100.0**	**100.0**

(1) Goods classified according to materials used

Export of traditional and agricultural goods with 7.5 percent rise amounted to $ 1,724 million in 1381, while its share declined moderately to 37.4 percent. Reduction in the share of export of traditional and agricultural goods was largely due to decline in the value of export of carpet by 6.9 percent. Export of industrial goods grew by 12.1 percent to $ 2,852 million, and its share with a slight increase reached 61.9 percent in 1381, against 60.2 percent in 1380. Among industrial goods, export of detergents and soap had the highest growth and that of footwear the highest decrease. Export of chemical and petrochemical products had the highest share of 24.3 percent in total non-oil exports, and export proceeds out of these products amounted to $ 1,118 million.

The geographical distribution of non-oil exports indicates that UAE, Germany, Azerbaijan, Japan and China with $ 1,728 million export from Iran accounted for 37.5 percent of non-oil exports. Export to Afghanistan with 189.2 percent growth had the highest growth and export to France with 40.4 percent reduction had the highest decline among the trade partners of Iran.



The geographical distribution of non-oil exports by group of countries is indicative of the high share of non-oil exports to ESCAP member countries by $ 1,933 million (41.9 percent), representing the most important export market. Exports to OPEC member countries amounted to $ 1,311 million, accounting for 28.4 percent of non-oil exports.

The geographical distribution of exports by continents indicates that Europe and Asia accounted for 93 percent of non-oil exports markets. Moreover, exports to America and Africa grew by 19.3 and 35.5 percent, respectively, so that these two continents totally accounted for $ 309 million (6.7 percent) of non-oil exports.

Transit Transactions

In 1381, about 4,811 thousand tons of goods transited into the country, showing 58 percent increase compared with the previous year. Of the total transit goods, 72.5 percent were transported by truck and rail, and the remainder consisting 27.5 percent oil products, was transported through swap arrangements. The share of oil and non-oil goods of total transit goods entering the country (excluding the swap) was 11.1 and 88.9 percent, respectively. The share of oil products including the swap would increase to 35.5 percent. In 1381, the transit of oil products (excluding the swap) and non-oil products grew by 18 and 33 percent, respectively. The transit in the form of swap shows a gargantuan rise of 254 percent.

In 1381, the amount of truck and rail transit was 2,684 and 808 thousand tons, respectively. The share of truck and rail transit in the total transit goods (excluding the swap) was 76.9 and 23.1 percent, respectively.

UAE, Turkey, Turkmenistan and Azerbaijan with 44.3, 12, 6.2 and 5.6 percent share respectively in total weight of transit goods had the highest share among origin countries. In contrast, Afghanistan, Azerbaijan, Turkey, Turkmenistan and Nakhichevan with 25.8, 13.3, 8, 7.6 and 4.3 percent share, respectively, were the most important destination countries.

Bilateral Trade

In 1381, barter transactions in the framework of clearing, special account(1) and the Asian Clearing Union transactions grew by 10.2 percent from $ 1,948.4 million to $ 2,148.7 million. In this year, receipts from special and clearing accounts amounted to $ 477.6 million ($ 431.9 million from special account transactions) which showed 187.7 percent increase compared to the previous year. During this year, barter transaction payments decreased by 63.9 percent to $ 49.4 million. Transactions in the framework of ACU fell by 1.5 percent compared to the year before to $ 1,621.5 million, and as the previous year enjoyed $ 1,207 million surplus. The mentioned surplus was owing to $ 1,414.2 million receipts from exports and $ 207.3 million payments for imports. Iran stood the first in terms of the trade surplus and ranked the second after India in terms of the volume of exports among ACU member countries.

(1) Special account includes those accounts opened for the registration of special activities based upon contracts concluded between central banks for special transactions with specific credit ceiling.