This report is restricted to those members of the staff to whose work it directly relates.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PRESENT ECONOMIC SITUATION

AND

CREDITWORTHINESS OF IRAN

July 21, 1950

Economic Department
Prepared by: F. G. Bochenski
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### Basic Statistics

#### Total Area
- Of which cultivable: 400 million acres (628,000 sq. miles)
- Of which cropland: 124 million acres
- Of which 41 million acres

#### Population (rough estimate)
- 18,500,000

#### National Income (rough estimate)
- Per head
  - R. 43 billion
  - R. 2,300 = $71

#### Currency
- Unit: Rial (R. = 100 dinars)
- Exchange Rate - Official (per)
  - R. 32.25 = U.S. $1
  - R. 40.00 = U.S. $1

#### Prices
- Wholesale prices:
  - 1937 = 100
  - 1949 = 571
- Cost of living:
  - 1937 = 100
  - 1949 = 895

#### Public Finance
<table>
<thead>
<tr>
<th></th>
<th>1947/48</th>
<th>1948/49</th>
<th>1949/50</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>6,716</td>
<td>7,169</td>
<td>7,194</td>
</tr>
<tr>
<td>Expenditure</td>
<td>6,774</td>
<td>7,739</td>
<td>8,690</td>
</tr>
<tr>
<td>Deficit</td>
<td>58</td>
<td>570</td>
<td>1,496</td>
</tr>
</tbody>
</table>

#### Foreign Trade
- (excluding oil exports and imports of Gov't. and foreign companies)
- Imports: 4,706
- Exports: 2,324
- Excess of Imports: 2,382
- 4,226
- 1,798
- 2,428
- 5,280
- 1,170
- 4,110

#### Sterling Receipts from AIOC
- Royalties, taxes, profits: 944
- Purchases of rials: 1,591
- 1,190
- 2,094
- 1,300
- 2,200

#### Balance of Payments
- Surplus: 210
- 1,302
- 992

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SUMMARY AND CONCLUSIONS
ON IRAN'S CREDITWORTHINESS

1. Iran is a typically underdeveloped area. The standard of living of the population is very low, the standards of health and education are unsatisfactory, and the administrative and economic organization of the country is primitive and inefficient.

2. The country, nevertheless, has substantial unutilized resources, consisting predominantly of a large reserve of potential cropland, which could be profitably brought under cultivation through a fuller utilization of the available water supply. Petroleum, Iran's most liquid asset, is providing the financial basis for such economic development and should continue to do so on an increasing scale during the next few decades.

3. The use of government petroleum income for the general development of the country constitutes the basis of the Seven Year Plan. In contrast to the development program of the thirties, which concentrated on industries and transportation and favored urbanization, the Seven Year Plan, involving a total expenditure of $650 million, aims at the development of all productive resources, simultaneously with the improvement of health and social services. While during the first years most of the financing and the management of the Plan are to be provided by the Government, the Plan envisages the participation of private capital at a gradually increasing rate. The carrying out of the Plan is entrusted to the Plan Organization, an authority which promises to be less involved in politics and somewhat more efficient than the Iranian civil service. Examined from every angle, the Plan appears to be a very necessary and sound endeavor and, from its inception, has been welcomed by the population among whom it has raised great hopes.

4. The first year of Plan operations, while not altogether disappointing, did not affect appreciably the present or future volume of production, particularly because the budget of the Plan was reduced and less than 50% of planned
expenditures went into new projects. Contrary to original intentions, the Plan Organization was shouldered with the responsibility of reorganizing and financing state industries, many operating with a loss, and of carrying out some works relief programs for the employment of destitute peasants. These changes came as a result of recent economic developments in the country.

5. For about a year now Iran has shown unmistakable signs of a business recession. Unemployment has increased, the volume of internal trade has dropped appreciably, and losses of merchants have been reflected in an increased number of failures. There have been several causes of this development. The exceptionally severe winter 1948/49, followed by a summer drought, brought extensive damage to crops and livestock, thus diminishing the income of the agricultural population. The devaluation of currencies in several countries exporting to Iran reduced the cost of some imported goods to a point where domestic production found it difficult to compete. Realizing that domestic deflation is a necessary consequence of the non-devaluation of the rial, the Bank Melli helped to speed up the process of readjustment through the restriction of credits, in order to force local industries to reduce their production costs and, also, to limit the existing speculation in goods, real estate, etc.

6. The Iranian Treasury accounts (cash receipts and disbursements) indicated a budget surplus in 1946/47 and relatively small deficits in 1947/48 and 1948/49. In the 1949/50 fiscal year, the Government ran a deficit of R. 1.6 billion which was caused by a substantial increase in military expenditure and by the assigning of oil revenues to the Seven Year Plan. This deficit would have been even greater had some of the development funds not been retrieved in a roundabout way by the shifting of various old liabilities to the Plan Organization. The remaining gap was covered by borrowing from the Bank Melli. Thanks to the import surplus and to the accumulated supplies of comparatively cheap imported consumer goods, this method of deficit financing has not, as yet,
reversed the recent downward trend of prices. A price rise may, however, be expected if the note issue is to be increased, a development which may be facilitated by the proposed change in the present note coverage requirements.

7. The general budgetary situation is likely to improve, but probably less through decreased expenditure than through increased revenue; it may be affected almost immediately by higher income from oil under the new arrangements with Anglo-Iranian as soon as this goes into force and, in the longer run, by a higher and better administered income tax. In the meantime, difficulties in the financing of the domestic requirements of the development plan may well continue to slow down the originally-planned pace of investment.

8. The financing of the foreign exchange component of the Plan, on the other hand, is less of a problem, due to the continued supply of foreign exchange provided by the oil exploitation. Over a number of years, receipts from this source have proved sufficient not only to offset the balance of trade deficit but also to provide Iran with surpluses in the form of gold and foreign exchange. Even the exceptionally high outgoing payments of the year 1949/50 (which resulted in an outflow of foreign exchange) would have been more than covered by these receipts, had the Iranian parliament decided to accept the amended oil agreement. Although negotiations in this matter may still continue for some time, it is unthinkable that they would result in a deterioration of the terms already approved by the company; for all practical purposes, therefore, the considerable increase of oil revenue, including substantial back payments, can be counted among the future assets of the country.

9. The Government's present gold and foreign exchange holdings amount to $260.3 million, of which $187 million is required as note coverage. The proposed change in the currency reserve, consisting of a lowering of the requirements for
note coverage in gold and foreign exchange from the present level of 77% to 50% of the note issue, could result in the release of an additional $68 million (or equivalent) for import purposes and for additional note issue.

10. Iran's balance of payments has shown surpluses for a number of years. The gold and foreign exchange reserves rose steeply during the war and reached a maximum in 1948. They have declined since, due to the deficit incurred in 1949/50 as a result of higher imports. This deficit should not, however, give rise to serious concern, in view of the fact that forthcoming additional oil revenue which would more than offset this deficit, depends entirely on Iranian ratification of the proposed agreement. All the information available on the further prospects of oil revenue for Iran points toward an undiminished and presumably even increased flow of foreign exchange receipts from this source. According to Iranian sources, Iran would have lost more than it would have gained if it had followed the devaluation of the pound in September, as the loss in income from local expenditures of Anglo-Iranian would have more than offset potential increases in exports.

11. It cannot be expected, however, that the carrying out of the Seven-Year Plan will leave the balance of payments unaffected; imports will increase as development proceeds. Though no exact estimate can be made at present, it is generally believed that such imports will not proceed at a more rapid pace, on the average, than the expected increase in oil revenues and anticipated foreign assistance. It can also be expected that investments will lead, in the long run, to a reduction in the level of imports of foodstuffs and such manufactured goods as textiles or cement.

12. Since the dollar balance of payments of Iran has a heavy deficit, the convertibility of sterling royalties and other oil receipts accruing to Iran is
the crucial element in any forecast as to the ability of Iran to secure additional dollar debt. Past experience of convertibility (in 1948 the U.K. converted about £ 14 million into dollars and in 1949 approximately £ 22 million) and the importance of Iranian oil to the British Empire indicate that the convertibility of further amounts, if needed for the servicing of foreign obligations, should probably not raise insuperable obstacles on the part of the U.K.

13. The internal and external debt of the Government is small. The internal debt of the Iranian Government is practically all with the Bank Melli. As of March 20, 1950, the Government's net liability with the central bank was R. 3,673 million ($114 million). In 1948 the Iranian Government repaid the last portion of the 1911 sterling loan (£ 1,250,000 originally, at 5%, secured by customs receipts). At present, Iran's only external public debt is an obligation of approximately $27.4 million (as of December 31, 1949) to the U.S. Government, payable in dollars over a twelve-year period. The annual cost of servicing and repaying the existing U.S. Government loans at present amounts to $3.5 million; it will decrease to $2.5 million in 1953.

14. In view of Iran's record in the past and of the present attitude of the Government to the development program and to IBRD assistance, there can be no doubt that the Government has the will to meet such obligations as it may incur under an agreement with the IBRD. The question whether Iran will have the means to service additional debt service in moderate amounts up to $2 or $3 million a year depends less on the Iranian overall balance of payments prospects which are not too easy to assess and on the whole not unfavorable, than on the willingness of the U.K. Treasury to convert Iranian £ holdings into U.S. dollars. Under present conditions the outlook in this respect is good but may warrant further inquiry.
15. As the Iranian investment plan progresses, the country will presumably require financial assistance on a larger scale in the future. Should the Seven Year Plan be carried out at the scheduled rate, the need for such additional financing may arise within a year. It is believed that Iran would qualify for financial assistance on a scale substantially larger than the one considered at present only under the following assumptions:

(a) That the specific projects submitted will not only be suitable for IBRD financing, but will also fit in with development priorities assumed when the Seven Year Plan was established. This involves, in particular, devoting an important share of the investment to agricultural development;

(b) That both the balancing of the budget and the financing of the local currency requirements of the development program are carried out through measures which will not have long-run inflationary effects on the economy of the country;

That further efforts are made to bring state enterprises to operate on a genuinely profitable basis or to dispose of them;

(c) That a consistent, general economic policy, particularly in matters concerning credit, prices and wages be adopted, followed by the Government, and coordinated with its development program.

On many of these points the present policy of Iran is still not clearly defined.
I. THE SEVEN YEAR DEVELOPMENT PLAN

A. The Origin of the Plan

16. Iran is a typical underdeveloped country. Some 70% of the population live from agriculture and the latter provides up to 80% of Iranian exports (other than oil). The area under cultivation is small and yields are low; both could be substantially increased by the improvement of agricultural techniques and investment in irrigation. The next important asset of the economy, petroleum, is exploited in only one strip of the country; the oil experts feel that production could be profitably expanded to other areas as well.

17. The rail and road nets are completely inadequate to link the distant provincial centers of the vast country; their development would contribute to a better integration and balancing of Iran's economy and would replace the existing tendencies to local self-sufficiency by a nation-wide division of labor. The present low standards of health and education are another handicap to an increase in production.

18. A fuller utilization of the existing resources of the country, including manpower, is the purpose of the Seven Year Development Plan. After several years of preparatory studies and discussions, this comprehensive program was approved by the Iranian parliament in 1949 and operations were started in July of that year. The total cost of the Plan amounts to rials 21 billion ($650 million, of which about $200 million is in foreign exchange) and is to be financed from the following sources: oil revenue, loans from the Bank Melli, loans from the IBRD, domestic and foreign private capital and sale of state-owned enterprises. The total investment is to be allocated as follows:
<table>
<thead>
<tr>
<th>Project</th>
<th>In Billions of Rials</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and Irrigation</td>
<td>5.25</td>
<td>25</td>
</tr>
<tr>
<td>Transportation</td>
<td>5.0</td>
<td>24</td>
</tr>
<tr>
<td>Industries and mines</td>
<td>3.0</td>
<td>14</td>
</tr>
<tr>
<td>Posts, telegraphs, etc.</td>
<td>0.75</td>
<td>4</td>
</tr>
<tr>
<td>Oil</td>
<td>1.0</td>
<td>5</td>
</tr>
<tr>
<td>Social and municipal reforms</td>
<td>6.0</td>
<td>28</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>21.0</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

19. The concentration on agriculture, transportation and welfare projects, which together account for 77% of the proposed total expenditure appears generally justified in a primary producing country, much of it inaccessible through lack of communications, where more intensive industrial development will have to be preceded by such preparatory steps as production of power, better transportation and training facilities. This was proved by the unfavorable experience with some of the existing industries such as textile plants, chemical factories and mines, which were created with governmental support in the thirties.

20. The carrying out of the Plan was, at the time of the Mission's visit to Iran, in the hands of a Plan Organization with a legal personality and financial independence. Government agencies entrusted with the execution of parts of the Plan were under the direction of the Plan Organization; the Council of Ministers was called upon to settle possible disputes. The Overseas Consultants, Inc. (OCI), a group of 11 U.S. engineering and industrial firms who, under contract with the Iranian Government, had surveyed development potentialities since 1948 and prepared reports and recommendations, were currently assisting the Plan Organization in an advisory capacity.

21. The total volume of the proposed investment, amounting to the equivalent of some $35 per head of the population or to an annual amount of about $5 per capita, does not seem excessive in proportion to the national income of Iran,
estimated at around $70 per head, since resources from abroad are called on to contribute a substantial share.

B. The Beginning of Operations

22. The activities of the Plan Organization in its first year have centered around the reorganization of the industries of the former Industrial and Mining Bank, the execution of several emergency programs, such as livestock vaccination to control the outbreak of rinderpest, insecticide campaigns in agriculture, road repairs, railway construction, some tractor ploughing of new lands in Azerbaijan - and the continuation of development studies and further planning. The taking-over of existing industries by the Plan, many operating at a loss, has taxed rather heavily the administrative setup of the new organization, and has absorbed over 50% of the total allocation of funds in the first year.

23. As a result of the preoccupation of the Plan Organization with already existing industries, investment has been curtailed in other fields. While no specified annual budgets were laid down by the Law of the Seven Year Plan, certain allocations were proposed for the various years by the OCI report. The following table gives a comparison of the actual expenditures of the Plan Organization during the first 9 months of activities with the OCI recommendations for an approximately comparable period.

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1/ With regard to this section, reference is made to App. II. to the Loan Department's operational report which covers the subject more extensively.
ACTUAL EXPENDITURES OF THE PLAN ORGANIZATION IN 1949/50 AS COMPARED WITH OCI RECOMMENDATIONS

(in millions of rials)

<table>
<thead>
<tr>
<th></th>
<th>OCI Recomm.</th>
<th>% of Total</th>
<th>Plan Org.</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Sept. '49-March '50)</td>
<td></td>
<td>(July '49-March '50)</td>
<td></td>
</tr>
<tr>
<td>Social Services</td>
<td>218</td>
<td>18</td>
<td>25</td>
<td>2</td>
</tr>
<tr>
<td>Agriculture and Irrigation</td>
<td>279</td>
<td>23</td>
<td>226</td>
<td>15</td>
</tr>
<tr>
<td>Transportation</td>
<td>155</td>
<td>13</td>
<td>173</td>
<td>11</td>
</tr>
<tr>
<td>Industry and Mining</td>
<td>410</td>
<td>35</td>
<td>191</td>
<td>12</td>
</tr>
<tr>
<td>Oil</td>
<td>20</td>
<td>1</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>Other Projects</td>
<td>106</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total New Projects</td>
<td>1,188</td>
<td>100%</td>
<td>628</td>
<td>40%</td>
</tr>
<tr>
<td>Financing of Subsidiaries</td>
<td>-</td>
<td>-</td>
<td>832</td>
<td>52</td>
</tr>
<tr>
<td>Administration</td>
<td>-</td>
<td>-</td>
<td>123</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>1,188</td>
<td></td>
<td>1,563</td>
<td>100%</td>
</tr>
</tbody>
</table>

24. It is apparent that the cut was most severe in the case of social services where the actual allocation dwindled to 2% against the recommended 18% of the total; the most unfortunate cut occurred in the proposed expenditures on agriculture and irrigation, from the proposed 23% (25% for the total plan expenditure) to 15% of the total. Related to total expenditure on new projects alone, however, the share of agriculture and irrigation is higher than was originally anticipated.

25. The total output of the country has not yet been visibly affected by the Seven Year Plan - although some losses may have been avoided by anti-pest campaigns. The first results are expected in about another six months in the form of increased production of sugar beets, cotton, and jute. The stronger accent on new projects in the proposed budget for 1950/51 is to be welcomed. Depending on the availability of funds, a minimum and a maximum budget of rials 2 billion and 3.4 billion respectively, has been prepared for this year.
26. The failure of the Plan Organization to concentrate, from the beginning, more fully on new productive investment becomes understandable when viewed against the background of recent general economic developments and trends in Iran. The reorganization of government industries would, in any case, have been a prerequisite to new investment activities and the relief work financed by the Organization would have otherwise increased the current deficit of the ordinary budget. The net effect of the apparent distortion of the first year operations of the Plan has been not so much a fundamental change in the Plan, as a slowing down of the rate of new investment.

27. The internal financial position of the country, reviewed in the next chapters, indicates that the possibility of further delays in the development program, similar to those of the first year and due to similar causes, cannot be excluded.
II. RECENT ECONOMIC TRENDS

A. Prolonged Effects of the War

28. The last war affected the Iranian economy in many ways. Large Allied military forces were stationed in the country and their expenditures, coupled with the inevitable deficiencies of supply, left Iran at the end of the war with a considerable stock of foreign exchange and an inflated price level. Between 1937 and 1944, the total money supply increased more than six times and the cost of living more than nine times. Inflation in Iran was not only more severe than in any other Middle Eastern country but post-war adjustments of prices were also longer delayed there than elsewhere.

29. This was caused not only by internal factors such as continued large government expenditure and decreased production, due to disturbances in Azerbaijan and several other provinces, but also by the loss of the pre-war export markets. Germany, which supplied, between 1936 and 1941, some 30 to 50% of Iran's imports and took between 20 and 40% of the country's exports, disappeared completely as a trade partner and is only now, gradually, beginning to return. Trade with Russia, another of Iran's traditional markets, dwindled from 35% of imports and 30% of exports before the war, to nothing in 1940 and, although trade resumed in later years, it never regained its former proportions and it is very limited at present. Distance and the inadequacy of transportation has handicapped a fuller development of trade with the U.S. and with Western Europe. Due to the drop of prices for Persian rugs and the increased price of imported textiles and sugar, the terms of trade for Iran had deteriorated. While all these factors contributed to continued low levels of production and incomes, a definite, though probably only temporary, deterioration set in towards the beginning of 1949 in connection with the long-delayed deflationary trend.
B. The Recent Business Recession

30. For about a year now, Iran has shown unmistakable signs of a business recession. Unemployment has increased, the volume of internal trade has dropped appreciably, and losses of merchants have been reflected in an increased number of failures. It is believed that the purchasing power of the population has been reduced below the level which would be compensated for by lower prices.

31. Several causes of this development can be singled out. The exceptionally severe winter 1948-49, followed by a summer drought, brought extensive damage to crops and livestock, thus diminishing the income of the agricultural population. At the beginning of 1949, the central bank of Iran (Bank Melli) undertook an appreciation of the currency. Having fairly large supplies of foreign exchange and control of the foreign exchange market, the Bank put exchange at the disposal of importers via the already-established certificate system, which brought the effective rate down (on dollars from a high of 60 rials at the end of 1948 to 40 rials by September 1949). The subsequent devaluation of currencies in several countries exporting to Iran reduced further the cost of some imported goods to a point where domestic production found it difficult to compete. At this time of falling prices, the considerable time lag between the placement of orders abroad and their appearance on internal Iranian markets, due to distances and transportation bottlenecks, made it impossible, in some cases, to resell imported goods at the prices originally calculated. Thus, losses of merchants were added to those of farmers and industrialists.

32. Realizing that domestic deflation is a necessary consequence of the non-devaluation of the rial, the Bank Melli helped to speed up this process through restriction of credits in order to force local industries to adjust their production costs and also to limit the existing speculation in goods, real estate, etc. This policy could not fail to aggravate, at least temporarily, the position of business, and particularly that of merchants who became increasingly dependent on the bazaar money lenders.
33. The repercussions of this business recession might have been even more severe and widespread than they actually are, were it not for the fact that an important part of the country's economy is state-operated and, therefore, less directly affected by factors damaging to private business. The state draws much of its income from oil, the volume of which is not influenced by internal trends in the Iranian economy and has been increasing steadily for a number of years.

34. The Seven Year Plan has not yet succeeded in starting a large scale investment program, which would provide a general stimulus for business activities all over the country. Traces of a certain improvement, however, have been noticeable during the last months, following the emergency works relief program of the Plan Organization on roads, railways, etc.
III. INTERNAL FINANCES

A. Public Finance

35. General - Iranian methods of budgeting and accounting are almost hopelessly complex. There is no uniformity in the presentation of the ordinary budget, while the financial results of state enterprises may appear variously on a net or gross basis and in either the ordinary or subsidiary budgets. No complete reports of realized state revenues and expenditures have been published for a number of years; semi-official summary data announced from time to time are often contradictory. The figures of actual revenues and expenditure, used in this report, are based on Treasury accounts which reflect cash receipts and disbursements in a comparatively reliable form but omit accruals and carry-overs from one year to another.

36. The following table shows the estimated and actual results of the last four fiscal years:

<table>
<thead>
<tr>
<th>Fiscal Year 1</th>
<th>Revenues:</th>
<th>Expenditures:</th>
<th>Deficits:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Estimated</td>
<td>Actual</td>
<td>Estimated</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(in millions of rials)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1946/47</td>
<td>5,417</td>
<td>5,797</td>
<td>6,094</td>
</tr>
<tr>
<td>1947/48</td>
<td>5,559</td>
<td>6,716</td>
<td>7,762</td>
</tr>
<tr>
<td>1948/49</td>
<td>7,909</td>
<td>7,169</td>
<td>9,038</td>
</tr>
<tr>
<td>1949/50</td>
<td>7,786</td>
<td>7,194</td>
<td>11,118</td>
</tr>
<tr>
<td>1950/51</td>
<td>8,948</td>
<td>-</td>
<td>11,473</td>
</tr>
</tbody>
</table>

37. Actual revenues are sometimes, actual expenditures are regularly, below estimates, in the latter case because of the limitations imposed by cash availabilities. Thus actual deficits are, as a rule, smaller than expected.

38. Main revenues and expenditures - During recent years the main sources of revenue have been: customs duties, amounting to about 24% of total revenues;
the tobacco monopoly, whose share of total revenues increased between 1939/40 and 1949/50 from 9% to 16%; and oil royalties which increased during the last ten years from 4% to 14% of the total. The rest comes from other monopolies, various indirect taxes, profits on foreign exchange transactions and from direct taxation.

39. Direct taxation in 1939/40 yielded about 8% and in 1949/50 over 10% of the total revenue. The present income tax rates reach 50% with regard to annual incomes above R. 1 million (§308,000) which, under Iranian conditions, are exceptional; incomes in the more frequently-occurring group between R. 100,000 to R. 300,000 are, however, only taxed from 10% to 15%. Even so, tax evasions are widespread.

40. Expenditure on development has now been largely concentrated in the budget of the Plan Organization, although some separate expenditure on roadbuilding, construction and investment in Government enterprises remaining outside the Plan, is foreseen. Since 1949, oil royalties have been firmly assigned for the execution of the Seven Year Plan; this undoubtedly reflects an intelligent realization that income accruing from exploitation of Iran's irreplaceable national wealth should be invested in the development of other productive resources on which the country can rely when the oil is exhausted.

41. Present and prospective income from oil - Oil production in Iran is, at present, entirely in the hands of a concessionsaire, the Anglo-Iranian Oil Company (Stockholders are: British Government, 56%; Burma Oil Company, 26%; general public, 18%). This company, which is registered in London under British Law, operates in Iran under a concession agreement dating from 1933 and covering a period of 60 years; a substantial revision of this agreement was negotiated between the Iranian Government and the company in July 1949, but so far it has not been ratified by the Iranian parliament. The company has the exclusive right to prospect for and to extract petroleum in an area of 100,000 square
miles along the west and southwest border of Iran as well as to process its output. It also has the right (though non-exclusive) to maintain pipelines, and to transport, process and sell petroleum throughout the country and to export it. The contractual privileges of the company include the right to import, without license, but against payment of tariff dues, all requirements of its staff; imports of equipment as well as the company's exports, are tax - and tariff - exempt. Also tax exempt are the operations of the company in Iran until 1963. The company is not obliged to exchange into Iranian currency any of its funds, including export proceeds.

42. The proposed 1949 revision of the agreement, which is to be retroactive to January 1, 1948, is primarily concerned with the company's direct payments to Iran. It raises the basic royalty from 4 to 6 gold shillings per metric ton of oil exported from or sold in Iran; it increases payments in lieu of taxes from 9 to 12 gold pennies per ton on production over six million tons; it provides for annual payments of Iran's share of the AIOC's general reserves, which previously were to be settled at the termination of the concession in 1993; it guarantees a minimum annual dividend and reserve payment of £4 million; and it fixes a payment of £5 million for Iran's share of the general reserves for the period prior to the effective date of the amended agreement.

43. Acceptance of the revised agreement will, therefore, substantially increase Iran's revenue from oil. While total payments of the company to Iran on account of royalties, taxes and profit shares amounted to over £9.1 million in 1948 and to almost £13.5 million in 1949, under the new terms the above payments would, for the 1949 production level, increase to some £23 million. The total amount due to Iran, representing back payments only, should be approximately £25 million by the end of 1950. This payment would consist of:

- £10.9 additional royalties for 1948 and 1949
- 5.1 Iran's 20% share of reserves for the period before 1948
- 8.7 Iran's 20% share of reserves for 1948 and 1949

Total £24.7
44. The main arguments brought forward in justification of Iran's reluctance to accept the revised terms of agreement are the following: a) The tax income derived by the U.K. Treasury from the AIOC is higher than the total oil revenue of Iran; b) This taxation, as well as the accumulation of hidden reserves as well as cheap fuel oil sales to the British Navy, reduces unduly the country's share; c) Even the revenues of the revised agreement are smaller than the revenues which would be due to Iran, if the Venezuelan formula of sharing profits between government and concessionaire on a 50-50 basis were applied.

45. It is estimated that, while, under the original agreement, Iran's oil revenue would work out at $1.80 per ton of extracted oil, the revised agreement will raise this sum to about $2.30. According to the available data, the corresponding revenues per ton for some other oil-producing countries are: $1.50 in Iraq; $0.70 in Kuwait; $1.50 in Saudi Arabia; $3.50 in Venezuela.

46. Considering the increasing demand for Middle East oil, as well as the growing refinery capacity of Western Europe, it can be assumed that extraction of oil in Iran, which in 1949 reached 28.2 million metric tons, will increase during the next 5 years by something like 15% and that most of the increase will be exported as crude oil. Should the project of a new pipeline leading to a Mediterranean port materialize, the increase would be even larger. Iran's proven oil reserves are estimated at 925 million tons (equivalent to about 9% of the world's proven reserves). Exploitation until now has been limited to the southwestern strip of the country but prospecting is planned in other areas by the new Iranian Oil Company, created under the Seven Year Plan.

47. There is therefore every reason to assume that Iran's income from oil will increase. Even now it covers around 25% of all the Government revenues. This revenue includes, apart from the royalties already discussed, various customs duties and sundry taxes paid by the company, as well as the Government's profits from foreign exchange operations of the company. The company purchases rials at
the official rate from the Government against sterling, which the Government then resells to importers at the considerably higher exchange certificate rate.

48. The Budgetary Deficits - Between 1946/47, the last fiscal year with a surplus, and 1949/50, actual expenditures rose by 55%. Except for customs receipts, which increased even more rapidly, none of the remaining groups of revenue has kept pace with this rate of increase. Oil revenue rose between 1946 and 1948 - the last year when it was included among ordinary revenues - by only some 15% under the terms of the existing agreement, although the increase would have been closer to 100%, under the new rates.

49. The deterioration of the budget position between 1948/49 and 1949/50 was caused on the expenditure side by a larger military outlay and on the revenue side by the loss of the oil revenue assigned to the Plan Organization. The resulting gap was reduced, however, by increased yields of customs and exchange operations as well as by transferring to the Plan Organization industries which have operated with losses. The Cereals and Sugar Administrations operate under separate budgets; owing to the subsidizing of bread prices, the former had losses which were not fully compensated for by the profits of the latter. If the financial results of these organizations are added to the ordinary revenues and expenditures for 1949/50, the deficit would increase to approximately R. 1.6 billion. (The Plan Organization, which also has a separate budget, showed receipts of R. 1.7 billion and expenditures of R. 1.6 billion.) The 1949/50 total budget deficit of approximately R. 1.6 billion was covered as follows:

- R. 0.3 billion - reduction of cash balances
- R. 0.6 billion - borrowing from the Bank Melli
- R. 0.7 billion - diversion of special funds, of which R. 130 million came from funds due to the Plan Organization.

50. With regard to future deficits, including the one foreseen for 1950/51, methods to lower expenditures and increase revenues are under consideration.
Among the former, there is a project to dismiss large numbers of the redundant civil servants during the next year, with compensation equivalent to a two-month's salary for every year of past employment. The total outlay on these compensations, estimated at approximately R. 1.5 billion (about 13% of the estimated expenditure for the current year) is to be borrowed from the Bank Melli and paid out in cash. No preparations are being made, however, for the training and reemployment of the released officials in productive occupations and the recently increased unemployment makes automatic adjustments unlikely. The effects of the large expenditures involved could not fail to be inflationary and the increase of the Government debt to the central bank would occur in a period when the budget is already unbalanced. The feasibility and wisdom of this project seem, therefore, extremely doubtful. Such economies as might be achieved by the dismissal of surplus officials without compensation, would be presumably offset by salary increases for the remaining staff. These increases are generally recognized as indispensable before higher standards of honesty and efficiency can be required or carried out.

51. On the revenue side, direct taxation reform — even if more conscientiously pursued than heretofore — will not yield quick results. The larger income from the AIOC, including the considerable back payments which will materialize in the case of parliamentary approval of the new agreement, is partly earmarked for the Seven Year Plan. According to certain Iranian sources, about £ 18 million (R. 1.6 billion) of the back payment may be available for general budgetary purposes. According to information received in July 1950, the oil company recently has loaned the Government £ 6 million (R. 540 million) interest free, the payment to be deducted from future oil royalties.

52. As there is no market in Iran for Treasury obligations, the Government continues to depend on the central bank. The responsibilities of the central bank include, therefore, not only the direct and indirect requirements of the
Plan Organization, estimated to be R. 750 million annually, but also the current financing of the Government's deficit. In the opinion of the Bank Melli, the Bank's present cash reserves, available for these purposes do not exceed the sum of about R. 600 million. The concern over the necessity of meeting the above requirements, apart from providing another motive for the restriction of commercial credit, has given impetus to the proposal to increase the Bank's lending capacity through a change in its note coverage.

53. This operation is to consist of a lowering of the gold and foreign exchange component of the note cover from the present 77% to 50%, which would free an amount of foreign exchange or gold equal to about $68 million (R. 2.2 billion). While about one-half or less of this sum would presumably be used to finance private and governmental imports, the remainder might serve as a cover for an additional issue. A large part of the new issue would probably be made available to the Government.

54. It may seem inappropriate to be concerned about the dangers of inflation in a country which at present suffers from a deflationary depression. Yet, such dangers exist and are likely to become acute as a result of some of the proposed methods of financing both development investment and the current budget deficits. It must also be remembered that, in view of the weakness of the country's private financial sector, any stimulus coming from the public sector may bring about unexpectedly strong reactions which will be further magnified by the general prevailing atmosphere of nervousness and insecurity, as well as by the existing inclination to speculate.

55. In these circumstances, continued attention must be paid to the maintenance of a balance between the supplies of money and of goods. From this point of view increased imports of consumer goods - which, though larger than in the first post-war years are still not excessive in comparison to the needs
of the country, judged by pre-war standards - must be regarded as justified, even at the expense of some temporary setbacks and adjustments of domestic production and investment. They will, presumably, have to be maintained until the effects of the Seven Year Plan can be felt in the form of an increased output.

56. The difficulties in financing the rial requirements of the Plan, together with an unbalanced ordinary budget, may therefore continue to be a limiting factor in the execution of the development program. Since inflationary solutions would tend to produce results detrimental to the economy and contrary to the aims of the Plan, the only alternative may be to slow down the originally planned pace of investment, e.g., by allowing foreign exchange to accumulate or by a temporary redirection of some of the current oil revenue for general purposes.

57. The public debt - External - In 1948, the Iranian Government repaid the last portion of the 1911 sterling loan (~1,250,000 originally, at 5% and guaranteed by customs receipts). At present, Iran's only external debt is the obligation of approximately $27.4 million (as of Dec. 31, 1949) to the U.S. Government, payable in dollars over a twelve-year period. This sum represents a balance of roughly $0.7 million for Lend Lease supplies and a balance of $26.7 million for purchases from the (former) OFCC. Interest and amortization of the total indebtedness are about $3.6 million in 1950, $2.6 million in 1951 and, after rising again to $3.5 million in 1952, gradually decline until the last payment of $2.1 million in 1961.

58. - Internal - The internal debt of the Iranian Government is practically all with the Bank Melli and, as of March 20, 1950, totalled R. 6,093 million (approximately $196 million). As the Government deposits at the same time amounted to R. 2,420 million, its net liability with the central bank was R. 3,673 million ($114 million).
B. Currency and banking

59. Bank Melli Iran \(^1\) combines the functions of a central bank with large-scale commercial operations. Although Government-owned, the Bank has succeeded, so far, in maintaining a considerable degree of independence. It has a well-established reputation for efficiency. The position of the Bank can be explained most easily by its balance sheet.

\(^1\) Reference is made to Appendix III to the Loan Department's operational report, which contains a more detailed analysis of the Bank Melli's position.
### BALANCE SHEET OF BANK MELLI IRAN

**20th March 1950**

#### Issue Department

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Notes Issued</th>
<th>Reserve</th>
<th>TOTAL LIABILITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes Issued</td>
<td>In circulation: 6,273</td>
<td>1,000</td>
<td>8,800</td>
</tr>
<tr>
<td>In Banking Dept.: 1,527</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reserve</td>
<td></td>
<td></td>
<td>15,563</td>
</tr>
<tr>
<td>TOTAL LIABILITIES</td>
<td></td>
<td></td>
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<table>
<thead>
<tr>
<th>Banking Department</th>
<th>Gold and Silver</th>
<th>Notes on Hand</th>
<th>Securities</th>
<th>Bills Receivable</th>
<th>Debtors</th>
<th>Acceptances, confirmed credits and guarantees</th>
<th>Miscellaneous</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital and Reserves</td>
<td>300</td>
<td>1,420</td>
<td>12,353</td>
<td>1,593</td>
<td>1,253</td>
<td>1,593</td>
<td>197</td>
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<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits</td>
<td>Government: 2,430</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Others: 8,804</td>
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<td>Savings</td>
<td>1,119</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL LIABILITIES</td>
<td></td>
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</tbody>
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<table>
<thead>
<tr>
<th>Assets</th>
<th>Gold</th>
<th>Foreign Exchange</th>
<th>Crown Jewels up to</th>
<th>Gov't. Liability secured by excess value of crown jewels</th>
<th>Deposits in Banking Dept.</th>
<th>TOTAL ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes Issued</td>
<td>7,800</td>
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<td></td>
<td></td>
<td></td>
<td>8,800</td>
</tr>
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<td>in circulation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>In Banking Dept.: 1,527</td>
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<td></td>
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<td></td>
</tr>
<tr>
<td>Reserve</td>
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<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL ASSETS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**
- Gold (incl. subscription to IMF of 282)
- Foreign Exchange (incl. subscription to IBRD of 24)
- Crown Jewels up to
- Gov't. Liability secured by excess value of crown jewels
- Deposits in Banking Dept.
- Acceptances, confirmed credits & guarantees
- Miscellaneous

**Figures in millions of rials.**
60. A part of the gold coverage, equivalent to $12 million, and $7.5 million of the foreign exchange component of the coverage, though included in the reserves, represent a part of the payment due to Iran for supplies and services for the Red Army during World War II, on which payment has never been made, although Russia has recognized the claim. Except for the IBRD subscription the remainder of the foreign exchange consists of sterling with the Bank of England. The R. 1 billion reserve in the Issue Department represents, for the most part, the gain from the 1941 rial devaluation which freed the corresponding amounts of gold and foreign exchange. The foreign exchange holdings of the Bank, apart from the note cover, amounted to the equivalent of $81 million of which $59 million were earmarked for current operational needs. These holdings are 93% sterling and the remainder is dollars.

61. The dominant position of Bank Melli among Iranian banks is clearly visible from the proportion of deposits of the Bank Melli to the total of bank deposits. The former rose from 76% in 1947/48 to 85% in 1949/50. Apart from Bank Melli, the only other important bank is the British Bank of Iran and the Middle East (former Imperial Bank of Persia) chartered in 1887, which is also the only wholly foreign-owned bank operating at present in Iran. The importance of this bank, which, at one time, enjoyed the country's sole note issue privilege, has declined recently, largely as a result of the new 1949 banking law which requires that foreign banks operating in Iran shall deposit with the Bank Melli 55% of their deposits. The British Bank has recently closed some of its branches in Iran. The remaining banks such as the Agricultural and Mining Bank, the Mortgage Bank (both state-owned), the Russo-Iranian Bank, the Army Co-operative Bank and the newly-created private Commercial Bank Bazargani, are of limited importance.
62. The banks pay between 2% and 4% interest on time deposits and charge between 6% and 8% for discounts and loans. The legal maximum interest rate for banks is 12%. The rates charged by the Bazaar money lenders range from 30% to 40%.

63. Small private business and agriculture throughout the country are severely handicapped by the lack of reasonably cheap credit. The provision of such facilities probably deserves precedence over the contemplated creation of a bank for industry linked with the Seven Year Plan. This widely-discussed project has been opposed by the governor of the Bank Melli with the argument that far from attracting or creating new capital, such a bank would, at the present stage, only duplicate the work of the Bank Melli.
IV. EXTERNAL FINANCE

A. Foreign Trade

64. Iran depends on foreign sources for almost every non-agricultural necessity and a part of its supply of sugar and tea. These two commodities, together with cotton goods, motor vehicles and machinery and tools of all types, are the largest import items. The government publishes annually import quotas for all goods which can be imported against official foreign exchange allocations at the official certificate rate. Additional imports must be financed independently. For the year 1949/50 import quotas amounted to R. 3.8 billion ($119 million) but over R. 5 billion worth of goods were actually imported. The main exports are carpets, dried fruits, rice, opium, gum, wool and animal casings.

65. The following table showing Iran's foreign trade, as well as trade data given in this section refer to the "commercial" imports and exports which exclude exports of oil, duty-free imports of the AIOC and some government agencies, and the comparatively small imports and exports of the Russo-Iranian Fishing Company.

<table>
<thead>
<tr>
<th>Year</th>
<th>Imports</th>
<th>Exports</th>
<th>Excess of imports:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1945/46</td>
<td>3,106</td>
<td>1,698</td>
<td>1,408</td>
</tr>
<tr>
<td>1946/47</td>
<td>4,115</td>
<td>2,570</td>
<td>1,545</td>
</tr>
<tr>
<td>1947/48</td>
<td>4,706</td>
<td>2,324</td>
<td>2,382</td>
</tr>
<tr>
<td>1948/49</td>
<td>4,226</td>
<td>1,798</td>
<td>2,428</td>
</tr>
<tr>
<td>1949/50</td>
<td>5,280</td>
<td>1,170</td>
<td>4,110</td>
</tr>
</tbody>
</table>

66. While the commodity composition of Iran's foreign trade has not changed much in comparison to prewar, there has been a definite shift in direction arising from the decline of trade with Germany and Russia. In recent years, about one-fourth of Iranian imports came from the U.S. and another fourth from the U.K.; before the war the share of each of these countries did not exceed 10%. With regard
to exports, the U.K., with over 20%, has become Iran's best market. Exports to the U.S. which, during the postwar years, represented, on the average, some 17% of Iran's total exports, have recently tended to decline. Trade with some of the western European and Middle Eastern countries, as well as with India, has risen slightly. Iran's trade with the U.S. is indicated below (in million U.S. dollars).

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports</th>
<th>Imports</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948</td>
<td>26</td>
<td>39</td>
<td>-13</td>
</tr>
<tr>
<td>1949</td>
<td>16</td>
<td>74</td>
<td>-58</td>
</tr>
</tbody>
</table>

As Iran's trade with other hard currency countries is, on the whole, negligible, the U.S. trade deficit represents approximate requirements of dollar (or hard currency) exchange. They are covered, as a rule, by convertible sterling arising from oil receipts.

67. The development program will affect Iran's foreign trade in several ways. The first years will bring a substantial increase of imports of equipment, some of it from the U.S. Throughout the operation of the Plan, the increased income of the population will also contribute to higher imports of consumer goods. During the following years exports should rise as a result of increased quantity and improved quality of agricultural products. The progress of the development plan should completely eliminate the need to import grain and cement and considerably reduce the imports of sugar and textiles.

B. Balance of Payments

68. The principal feature of Iran's external payments is the large receipts of foreign exchange from oil exploitation. During the years 1946/47, 1947/48 and 1948/49, receipts from this source proved sufficient not only to offset the balance of trade deficit but also to provide Iran with surpluses of gold and foreign exchange amounting to a total of $73 million.
IRANIAN IMPORTS, EXPORTS AND STERLING RECEIPTS FROM OIL
(BILLIONS OF RIALS)

YEAR ENDING MARCH 20

NOTES:
Exports exclude oil.
Imports exclude customs free imports of government and oil company.

No. 490
69. The following balance of payments of Iran for 1949/50 is based on official data; estimates of the balance of payments for 1950/51 show two alternatives, depending upon whether the new oil agreement will or will not be ratified. The data indicate that sterling receipts from oil, owing to Iran under the new terms of agreement, would more than offset the deficit of 1949/50 and would also be sufficient to cover the requirements for 1950/51.

<table>
<thead>
<tr>
<th>IRAN'S BALANCE OF PAYMENTS IN 1949/50 AND ESTIMATES FOR 1950/51</th>
</tr>
</thead>
<tbody>
<tr>
<td>(in millions of dollars)</td>
</tr>
<tr>
<td><strong>Receipts</strong></td>
</tr>
<tr>
<td><strong>Exports</strong></td>
</tr>
<tr>
<td>1949/50</td>
</tr>
<tr>
<td>36.0</td>
</tr>
<tr>
<td>Estimates:</td>
</tr>
<tr>
<td>Present oil rates - 1950/51 - new oil rates</td>
</tr>
<tr>
<td>36.0</td>
</tr>
<tr>
<td>Purchases of For.</td>
</tr>
<tr>
<td>Exch. from AIOC</td>
</tr>
<tr>
<td>69.0</td>
</tr>
<tr>
<td>AIOC royalties</td>
</tr>
<tr>
<td>40.0</td>
</tr>
<tr>
<td>U.K. railway debt repayment</td>
</tr>
<tr>
<td>23.0</td>
</tr>
<tr>
<td>Sundries</td>
</tr>
<tr>
<td>3.0</td>
</tr>
<tr>
<td>TOTAL</td>
</tr>
<tr>
<td>171.0</td>
</tr>
<tr>
<td><strong>Expenditures</strong></td>
</tr>
<tr>
<td><strong>Imports</strong></td>
</tr>
<tr>
<td>1949/50</td>
</tr>
<tr>
<td>144.0</td>
</tr>
<tr>
<td>Estimates:</td>
</tr>
<tr>
<td>Present oil rates - 1950/51 - new oil rates</td>
</tr>
<tr>
<td>135.0</td>
</tr>
<tr>
<td>Government and Plan Organization)</td>
</tr>
<tr>
<td>46.0</td>
</tr>
<tr>
<td>13.2</td>
</tr>
<tr>
<td>17.0</td>
</tr>
<tr>
<td>Sundries</td>
</tr>
<tr>
<td>12.0</td>
</tr>
<tr>
<td>TOTAL</td>
</tr>
<tr>
<td>202.0</td>
</tr>
<tr>
<td>Surplus or Deficit</td>
</tr>
<tr>
<td>-31.0</td>
</tr>
<tr>
<td>-21.8</td>
</tr>
<tr>
<td>-62.0</td>
</tr>
</tbody>
</table>

70. Government foreign exchange expenditures in 1949/50 include $26.7 million for imports of wheat, $12.0 million for imports of sugar and $6.3 million for other purposes including the Plan Organization. The 1949/50 deficit, the first in a number of years, occurred in spite of the $23 million non-recurrent receipt consisting of the Railway debt payment. The deficit arose from the considerable increase of governmental and private imports, combined with some decrease of exports.
71. The forecast for 1950/51 assumes in both alternatives commercial imports on a level lower than in 1949/50 (when they were exceptionally high and large stocks of goods accumulated) but higher than in preceding years, roughly corresponding to the prewar volume of imports and allowing for the increase of population. It is assumed that these imports would increase gradually during the development period. A high level of imports would be dictated by the desire to offset the increased purchasing power of the population derived from larger development expenditure.

72. Even under new oil rates the estimated balance of payments for 1950/51 would show a deficit of $3 million on current account were it not for the backpayment of royalties. The surplus arising from the latter should be used, therefore, to replenish the reserves of foreign exchange in order to provide cover for future deficits which may result from development expenditure and foreign loan service.

73. While devaluation of other currencies has affected Iranian exports, a devaluation of the rial would be unlikely to improve the balance of payments. Sterling receipts from the sale of rials to the AIOC, which represent about 40% of total foreign exchange receipts would drop automatically and it is doubtful whether this loss would be offset - let alone exceeded - by an increase of exports, which have recently contributed only some 20% to total receipts. The output of most of Iran's export goods, except for handmade rugs, cannot be substantially increased without previous investment. A study of price calculations for a number of these goods shows that the present profit margins in many cases are very narrow while some goods can now be exported only at a loss. Quicker results can be expected, however, from improved methods of production, as well as from the introduction of better methods of grading and packing. Such action is anticipated
under the Seven Year Program. Before it takes effect, export subsidies may prove to be a temporary solution for the difficulties of Iran's export trade.

C. The Foreign Exchange Position

74. Exchange Rates - The current system of exchange rates consists of the basic official rate ($1 = R. 32.25), the use of which has been progressively limited in scope and a certificate rate used for practically all import and export transactions other than those of the Government. Exporters receive, in addition to rials at the official rate, a foreign exchange certificate at 25% higher value which can be sold to authorized banks or individuals (importers, etc.). The Bank Melli has, since September 1949, stabilized the certificate rates at R. 40 to the dollar and at R. 112 to the pound. A certificate rate at a slightly higher level exists for a few transactions for which certificates cannot be obtained from authorized banks. The exchange rate on the quite freely operating black market is, at present, about R. 50 to the dollar. Apart from the aforementioned import controls, licenses are also required for most of invisible payments. Enforcement of controls and restrictions is not considered to be very effective.

75. The most important source of Iran's foreign exchange is the AICC, which pays royalties in sterling and purchases rials for sterling at the official rate, to cover expenditure in Iran. In 1949/50 receipts from these two sources together amounted to 63% of the total foreign exchange receipts of Iran.

76. Sterling Convertibility - The convertibility of Iranian sterling is regulated by a "memorandum of understanding" between the Bank Melli and the Bank of England, which was first adopted in 1947 for one year but has been currently renewed and amended. The original memorandum contained two major provisions:

(1) Iranian-held sterling can be converted into dollars to purchase goods "which the Iranian Government considered essential to the economy of Iran (and which) cannot be obtained on equivalent terms with respect to price, delivery date, and
quality either in the sterling area or elsewhere against sterling", and (2) the
Iranian accounts "carry a guarantee against depreciation in terms of gold." (The
second provision was applied after the sterling devaluation in 1949 and Bank Melli
received a payment of £8.8 million to offset such losses as otherwise would have
arisen). The extension of the agreement made in 1948, somewhat enlarged the facili-
ties granted to the Iranians in order to permit them to use sterling balances for
payment of goods imported from Japan and Western Germany as well as "for non-
commercial purposes such as diplomatic expenditure, students allowances in Switzer-
land and the U.S.A. provided that necessary and adequate care is taken as to their
expenditure."

77. The servicing of foreign loans in hard currencies is not specifically
included; the Bank Melli, however, seems to take the view that these cases are
covered by the 1948 amendment under the term "non-commercial purposes" and that
the words following "such as" should be regarded only as a statement of examples
and not as a complete enumeration of all cases considered. The last (1949) ex-
tension of the agreement did not introduce any changes; it expires on 20 November
1950, but will presumably be prolonged. The amounts of sterling actually con-
verted were equivalent to about $56 million during 1948 and $81 million in 1949.
## ANNEX

<table>
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<tr>
<th>J. The Political and Social Background</th>
<th>Page No.</th>
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<tr>
<td>B. The Political and Administrative Setup</td>
<td>1</td>
</tr>
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<td>C. Tensions Arising from the Existing Social Structure</td>
<td>2</td>
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<td>D. The Demand for Progress and Development</td>
<td>3</td>
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<table>
<thead>
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<th>Page No.</th>
</tr>
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<td>C. Other Mineral and Industrial Resources</td>
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Transportation Map of Iran - following p. 7
ANNEX

I. THE POLITICAL AND SOCIAL BACKGROUND

A. Effects of External Pressures on Internal Developments

As distinct from Egypt and the countries of the Arabian Peninsula, contemporary Iran has had a long period of uninterrupted though not unimpaired, national independence, maintained in the fact of the rival interests of larger foreign powers. External pressures, coming from various directions and assuming many different forms, not only diverted a great amount of governmental energy, which otherwise might have been directed toward economic and social advancement, but also left their deep marks on public life in general. The centuries-old necessity of maneuvering among foreign influences has created among the Persians a basic, though not always openly-demonstrated, distrust of foreigners. It is comparatively easy to kill any public action in Iran by accusing the initiator as serving foreign forces. The awareness of the strength of the forces facing Iran is reflected in a certain atmosphere of nervousness and instability which permeates the country's political and economic life.

B. The Political and Administrative Setup

Since 1906, Iran has been a constitutional monarchy with a government responsible to a parliament, the lower chamber of which (Hajliss) is fully, the upper partly filled by general elections. As in so many countries where western parliamentary democracy was suddenly superimposed on an ancient, partly feudal structure, the system does not work too well. It is, in particular, the absence of organized parties and party programs in Iran, which makes decisions of the parliament unpredictable and majorities unstable. In these circumstances, the Shah, who is backed by the army, must be regarded as the main stabilizing factor in the country; this modern educated ruler is generally acknowledged as an enlightened and well-intentioned person who maintains a vivid interest in the economic development of his country and in the Seven Year Plan. According to
the opinions of unbiased foreign observers and enlightened Iranians, the administration of Iran is inefficient, overstaffed, underpaid and partly corrupt. The Governments of the last years have shown some shrewdness and skill in their diplomatic relations with the outside world; within the country, however, the Government has shown little ability to promote stability or internal reform.

C. Tensions Arising from the Existing Social Structure

According to very rough estimates available, over 70% of Iran's population lives from farming and pastoral pursuits, over 10% from trade, some 9% from industries and handicrafts, while about 6% are employed by the State or in free professions.

Of the rural population, some 2 or 3 million nomads live in tribal communities under the most primitive conditions. The settled rural population consists mainly of tenants or agricultural workers who till land belonging to large landowners, under various systems of tenancy or sharecropping and, on the average, do not seem to receive more than two-fifths of the crops. The average income of this population is extremely low; it is sometimes estimated for a family of five at Rials 9000 (≈277) a year, but such estimates must be particularly vague as cash payments play only a minor part in the subsistence economy of this population. The landowning class is small and comparatively very rich, because of the large size of their estates rather than the size of profits which, on the average, under present backward agricultural methods, rarely exceed 5% of the capital value of the land.

The average real income of industrial workers is, generally speaking, somewhat higher than that of the peasant population. Increased unemployment, partial unemployment and some wage reductions have probably offset the benefits which may have resulted for the industrial population from the recent price drops.

The Iranian middle class is neither numerous nor influential. It consists mainly of merchants who suffered from the recent business recession and of State
employees who, in general, are grossly underpaid and demoralized by the necessity of supplementing their incomes by illegal takings.

While deep inequalities in income distribution and general standards of life are a notable feature of the Middle East, and conditions in this respect may not be very different in Iran, the greater poverty of Iran than of Turkey or even Egypt, renders the contrasts and resulting tensions more acute, while the proximity of Russia increases the dangers of their exploitation.

D. The Demand for Progress and Development

The economic inequalities and social tensions in Iran provide a background of restlessness and impatience which is not relieved by any great amount of popular confidence in the ruling group of ageing politicians and large owners who, for some time now, have been shifting cabinet posts among themselves, without admitting much new blood and without paying much more than lip service to the necessity of reforms.

The Tudeh party, which even before being outlawed had lost much ground among the highly patriotic Persians because of its obvious allegiance to Russia, appears to have recently increased its underground activities and following. The possibility of a more forceful political move is, however, more likely to come from the Army, probably with the backing of the dynasty and may be welcomed by the population, at least at first, as bearing promise of a change. The recent tendency to glorify the memory of the late Reza Shah, "the Great", reflects the yearning for strong leadership, which would cut a way for progress through all the procrastinations, muddle and pettiness frequently associated with politicians of the old school. It is too early to express any opinion about the significance of General Razmara's ascent to power, which took place at the time of writing. There are, however, many indications that his Government will attempt a thorough reform of the country's central and provincial administration.

The Seven Year Plan, widely advertised as a decisive step toward general
development and improvement has, so far, not brought results which, in the eyes of the wider public, would justify the hopes to which it gave rise. There is, therefore, a great need for some actual achievement, which by satisfying the anxiety of the intelligent and alert population, would channel their best efforts into harmonious work for the future of their country. While from the purely political viewpoint such achievements might as well be in the field of education, health, and social welfare as in any other part of the existing comprehensive development program, the economic situation in Iran demands that first priority be given to economic development and, in particular, to that part of it promising the quickest increase in production.

II. THE ECONOMIC BACKGROUND

A. General Effects of Geographical Factors

Nature has put a number of obstacles in the path of Iran's development. The country has a very large area (628,000 square miles), but one-third is deserts, and another third, rocky mountains. The population centers are, therefore, widely scattered and separated not only by considerable distances but by natural barriers such as salt deserts situated in the center of the country, or high mountain ranges which virtually cut off the fertile lands on the Caspian Sea from the rest of Iran.

Since most of the country is a high plateau averaging some 4,000 feet above sea level, only small quantities of water enter it by surface streams, mainly from Afghanistan, while Iran "exports" a large part of her not too abundant water supply to Iraq and Russia, in addition to the quantities which flow out into the Caspian Sea and the Persian Gulf.

The considerable geographic differences are not a total handicap to development. While they make over-all agricultural planning more difficult and complicated, they assure, on the other hand, a great variety of crops in Iran, ranging
from subtropical plants such as tea or rice to the cereals and fruits of the temperate zone.

B. Importance and Development Possibilities of Agriculture

About three-quarters of the cultivated land in Iran is devoted to grains (wheat, barley and rice), one-eighth to other field crops (mainly cotton, sugar beets, opium, tobacco and tea) and one-eighth to fruits and nuts (grapes, apricots, dates, citrus fruits, almonds and pistachio). Animals and animal products play an important part in the agricultural economy of Iran; sheep and goats account for about 80% of the total livestock.

In normal years some 90% of the total food production is consumed domestically, while the rest goes for exports. Wheat and barley, which are all-important for the domestic food supply, provide small surpluses for exports in good crop years but often show deficits, as in 1949 when around 250,000 metric tons of wheat had to be imported (mainly from Russia). The average caloric intake per head has been calculated by FAO at below 1900 calories, which compares unfavorably with some other Middle Eastern countries, such as Turkey (around 2200) or Egypt (over 2300).

Owing to a lack of modern methods of cultivation and to an insufficient water supply, about three-fourths of the country's cropland remain fallow every year and the area actually under cultivation does not exceed 10 million acres. This gives a density of some 0.5 acres per inhabitant and of some 0.7 acres per head of the settled agricultural population, which is not much above Egyptian standards and in terms of produce must be lower as hardly any soils in Iran can compare in fertility with the alluvial soil of the Nile basin.

\[1/\] Over 3000 calories in the U.S.

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The existing land tenure system which concentrates ownership almost exclusively in the hands of large, partly absentee landlords, who rent their land through a number of intermediaries to small tenants or sharecroppers, does not seem in general to provide for sufficient incentives either for the improvement of agricultural techniques or for the expansion of cultivation. Certain investigations seem to indicate that the best levels of production are achieved in cases of middle-sized holdings (one village per owner), which appears understandable in view, on the one hand, of the lack of interest shown by large owners and, on the other hand, of the poverty, the illiteracy and primitiveness of the individual peasant who - in many cases - is not prepared yet to apply improved methods on his own initiative.

Although in many areas the scarcity of water resources or the cost of making them available are limiting factors, experts believe that with proper investment the area of land under cultivation could be doubled.

Agricultural development in Iran would seem to require simultaneous action in a number of fields: Technologically - increased irrigation facilities, application of agricultural machinery and fertilizers, modern methods of seed selection, prevention of plant and animal pests; Legally - legislation favoring the creation of medium-sized farms; Financially - the spreading of credit facilities on reasonable terms; Educationally - the training of the agricultural population in the application of improved techniques and the use of machinery.

C. Other Mineral and Industrial Resources

Deposits of minerals, other than petroleum, their quality and the extent to which they are economically workable have never been thoroughly surveyed in Iran but, generally speaking, they seem to be richer and more varied than those of most of the other Middle East countries. Some coal is mined from several small pits northeast and northwest of Teheran; total output in 1947/48 was 200,000 metric tons. Iron ore deposits exist near Samnan (east of Teheran) but are not
exploited at present. Red oxide of iron is mined on the Hormuz Island in the Persian Gulf; all of the produce, which average some 10,000 tons per year, is exported. Small quantities of copper, lead, antimony, sulphur and rock salt have been mined.

Cottage industries which were flourishing in Iran before the industrial revolution in Europe, have ever since suffered from the competition of cheap, machine-made goods. They are limited today to some domestic weaving, enamelling, wood-carving, etc., which bear testimony of the artistic ability of the population but are, otherwise, of negligible importance. The weaving of woolen and silk rugs gives a total annual production of between 3000 and 6000 metric tons of rugs, some 75% of which are exported.

Until the end of World War I, industrial production in Iran was limited to a few power plants and match factories. Most of the existing factories were created between 1925 and 1940, either from public funds or with the encouragement of Reza Shah. Textiles, producing cotton, wool, jute and silk goods, are the most developed branch of manufacturing industries. The output of cotton piece goods covers up to one-half of the low current domestic requirements. Sugar plants, working on sugar beet, meet about one-third of the country's consumption. The only existing cement mill has a capacity of 300 tons per day, but actual output usually reaches only two-thirds of this quantity and covers, on the average, about 80% of domestic demand, which is bound to increase substantially due to the development program. Of other industries, the more important ones are chemicals and army munitions plants, some food processing plants, a factory of tobacco products and several establishments producing brick and other construction materials. The Iranian industries work mainly on domestic materials, with the exception of dyes and chemicals which are largely imported. Most of the plants generate their own power either by diesel engines or by turbines.

Generally speaking, industries in Iran suffer from poor management, a

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1/ Excluding duty-free imports of the AIOC
shortage of qualified technicians, an excess of unproductive labor and obsolete or worn-out equipment, some of which is only now, gradually, being replaced. Present production costs frequently compare unfavorably with prices of imported goods of similar quality.

D. Transport

Up to the year 1925, Iran had no railway lines except on small stretches in Azerbeijan, near the Beludjistan frontier and around Teheran. At present, the total length of all operated railway lines amounts to 2,262 kilometers. They consist, primarily, of the Trans-Iranian railway net, which was built before the war and is being expanded now by new branch lines from Mianeh to Tabriz, (of which 40 km have been completed and the remaining 190 km should be ready in 2 years), and from Sharud to Meshed (the remaining 400 km should be completed in about 3 years). Due to lack of motive power and proper maintenance the Iranian railways are not used efficiently; they have operated with deficits during the last years.

The total length of roads suitable for motor traffic is 16,700 miles of which about 800 miles are asphalt. As there is no roadbuilding or maintenance machinery available, all the work on roads is done manually. The country has, at present, about 29,000 motor vehicles.

Iran's main ports on the Persian Gulf are Khorramshar, Abadan and Bandar Shahpur; the ports of Bushire and Bandar Abbas play only a minor role. These ports handle annually from 500,000 to 800,000 tons of imports and, excluding oil products, up to 90,000 tons of exports. While Abadan is used by the AIOC and both Bandar Shahpur and Khorramshar handle imports, all Iranian exports, other than oil, go through Khorramshar. This port, developed during the war by an American contractor and the U.S. Army, is now badly congested due to bad management and inadequate equipment, and the main jetty is silting up. It is proposed to rehabilitate the port with IBRD assistance.
The Caspian seaports Bandar Pahlevi, Bandar Shah and Novshahr are very little used, at present, due to decreased trade with Russia.

E. Labor

The number of industrial workers employed at present in Iran is estimated at 210,000 and that of handweavers and other craftsmen at 100,000. Up to 100,000 additional workers are unemployed at present.

No statistical data or estimates exist with regard to agricultural labor and unemployment; seasonal underemployment of the rural population must occur regularly, though its effects are sometimes relieved by domestic crafts. There is, however, one aspect of agricultural unemployment which, although statistically unexplored, was brought rather forcibly to public attention when, in the fall of 1949, a large number of destitute Azerbeijani peasants descended on the towns of Tabriz and Teheran and had to be taken care of, employed or repatriated at a total expense probably far in excess of that which, in the form of timely relief, would have prevented their migration.

The fairly modern Labor Law provides for minimum wages of industrial workers, based on the value of a food basket, which at present comes to between R. 34 and 40, depending upon the district. The AIOC supplies most of the basket goods to its workers at controlled prices; this practice prevented the necessity of increasing wages temporarily, at a time when local food prices soared.

As far as can be established, real wages have remained stable or have even slightly increased in comparison to pre-war levels. Generally speaking, the position of workers in government-owned factories is better than of those in privately-owned industries which not infrequently fall into arrears with wage payments.

F. The Strength of the Public Sector in Iran's Economy

About one-fifth of all the agricultural land belongs to the State, to the Royal Family or to various foundations. Roughly speaking, one-half of all the
industrial establishments is government-owned as are the railways, while bus and truck transportation is in private hands. Government-owned banks dominate the money and credit market.

The numerous State monopolies include: the sale and processing of tobacco and opium; distillation of alcohol; production of sugar; imports of cotton piece goods, automobiles, matches, playing cards, etc. Many of these monopolies remain as a result of the Foreign Trade Monopoly Act of 1931, introduced by Reza Shah with the object of encouraging and protecting domestic industries. While until 1941 all imports were a State monopoly, later on many commodities were freed from these restrictions; the monopolies on some of the remaining ones have developed into a system of licenses and special taxes under which private individuals are permitted to operate.

The high degree of State interference in Iran did not emerge out of any collectivist doctrines, but was motivated by the national aspiration to economic independence and fuller development. It is understandable that in a country which, at one time, was divided into spheres of influence by foreign powers, had its customs duties pledged to secure a foreign loan and carried out the largest part of its pre-war trade with totalitarian countries, the Shah not only wanted to strengthen the economy by what he believed was the quickest possible method, but also to concentrate economic power and foreign trade in the hands of a central authority, which would have more bargaining power than individual, largely inexperienced, small-scale operators.

Most of these conditions are a thing of the past, but the scarcity of private capital and the apparent reluctance of Iranian entrepreneurs to combine forces in order to undertake large-scale investment are factors favoring continued "statism" in Iran.

The investment program of Iranian Governments in the past and present involves, of course, certain dangers, the most important of which is the development
of uneconomic production facilities which can only survive under heavy protection. Of the existing State enterprises, the sugar refineries, the Government-owned banks, the Tobacco and Opium Monopolies are among those which show regular profits, while textile mills, coal mines, agricultural companies in the provinces and the Bread and Cereal Administration experience deficits.

While the economic activity of the State was most intense under the rule of Reaz Shah, private enterprise has begun to come into its own since World War II. The prospects are that the Seven Year Plan, during its first years, will again strengthen the public sector, but it is intended that private capital will gradually take over publicly created enterprises in the following years.

G. **Attitude to Foreign Business and Capital**

As the Seven Year Plan envisages the use of credits "from foreign commercial organizations," the attitude of Iran towards foreign business and capital in the past becomes a matter of some importance. Legislation has not always been altogether conducive to encouraging the activities of foreign business. Although the provisions of the Mining Law, which makes mining concessions for foreigners dependent upon parliamentary approval, is understandable, the limitation of import permits to Iranian citizens and companies financed by them or the law on foreign banks may be open to question.

Measures of this type, however, are by no means limited to Iran. They represent the revival of economic nationalism, particularly acute in underdeveloped countries, and relatively justified in such areas as the Middle East where past experience with foreign economic interests was often painful. The actual working conditions for foreign business people in Iran seem better than in some Middle Eastern countries. The community of foreign merchants (largely Iraqi Jews and Lebanese) seems comparatively well off. On invitation from the Iranian Ministry of Finance, a French expert has been preparing suggestions for a new banking structure, which would undoubtedly affect private banks.
As far as future policy is concerned, the Iranian authorities have declared themselves repeatedly in favor of encouraging foreign investment and the recent formation of the strongly pro-western Razmara Government can only strengthen these policies. The participation of foreign capital in the Seven Year Plan is clearly foreseen by the Law and the presence of a number of foreign technicians in Iran, both within and outside the OCI, promises to facilitate such a development.