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## Iran's Economy & Energy Subsidies

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Establishing a pricing system in Iran, particularly for fuel and energy, has always been a complex issue. Even though there seem to be differing views on the definition of subsidy and on how to eliminate it, no one appears to be against its existence, which is a main cause of uncontrolled consumption and hence an obstacle to any improvement in the country's economy.

The politically charged atmosphere in Iran forestalls addressing important issues rationally. At times a single neoclassical method, amongst many others, is highlighted by some as the only way out, blocking the path for putting forth a logical solution to a problem. It becomes more damaging when the neoclassical approach is not even attuned to the prevailing conditions in Iran.

Subsidy is an important economic tool that can be used successfully to prop up the macro economy of a country. But when it is used to the disadvantage of the economy of a country it can not be defended by any economist.

The deep-rooted and complicated economic issues in Iran are the main reasons behind the conflicting viewpoints. But any hasty approach in dealing with such issues could lead to harmful consequences.

Leaving a cancerous tumor untouched in a patient's body may sometimes be the best treatment for it because surgery could prove to be even more detrimental.

But is inaction a solution, or is there actually a solution to this chronic problem?

Apparently two very specific and complementary long-term solutions can be considered for ridding Iran of the subsidies in a gradual way.

### **Solution 1**

A model for the country's economy can be created to see what happens if the energy subsidies are eliminated.

What will in reality happen when the subsidies are removed? How will the real prices affect people's consumption? What energy-conservation projects will be doable?

Since real prices are seen as 'shadow' prices in the economy, if there are projects that can be carried out at the real prices and are good for the economy, shouldn't they be identified and the subsidies be allocated to them for their speedy implementation?

This effectively constitutes the non-price solution.

### **Solution 2**

The second factor that can pave the way for the long-term rationalization of prices is a solid determination to avert generation of new subsidies. The fact is that those very people who are against energy subsidies because "subsidies prevent enhancement of Iran's economy" keep generating huge

volumes of new subsidies in the form of annual budgets!

For instance, in each annual budget of the country the government is required to provide the cities and villages close to the national gas pipeline with gas and the only criterion for it is the 'distance' between the pipeline and the city or the village. It began with 5 km 'distance' and has now reached 15 km.

The economic rationale of gas distribution has nothing to do with 'distance'. As far as this rationale is concerned, supplying gas to a village/city with sizeable population in a cold area that may even need gas for industrial use and is 20 km away from the line is surely preferred to supplying gas to a village/city with scanty population in a hot area that has no industrial gas need and is 14 km away from the line.

When gas is supplied merely on the basis of distance and the other factors like capital expenditure, transfer cost and size of the population are ignored then effectively a new kind of non-transparent subsidy is being generated. But, if the calculations are given the needed transparency then we may come up with more suitable ways of securing the energy needs of some cities and villages. For instance, perhaps local energy potentials could be tapped for the purpose and, in the bargain, job opportunities are created for the inhabitants too.

Another example is to do with 'investment projects', which usually suffer either from poor technical and economic studies or are justified only because energy prices are subsidized.

In order to avert regeneration of subsidies, in both the public and private sectors, permission should be given only for the kind of investment projects that can produce good rate of return at real prices of energy carriers. If an investment proves to be uneconomical at real prices it will naturally result in loss if the subsidies are eliminated. And such an investment will effectively impose the loss on the economy of the country.

Even if other aspects, such as national security or job creation, are the real motives behind an investment, the most suitable approach would still be to conduct two similar feasibility studies, one on the basis of subsidized prices and another on the basis of real prices. Outcomes of the two can then be compared to arrive at transparent amount of subsidies, which can in turn be used for making the right decision.

Besides, when Iran's membership of WTO is final, these very subsidies, especially in energy, will come under pressure. Transparency in the amount of subsidies will also help the country to weigh what should be expected once full membership of WTO is attained.

If serious notes are made of the aforementioned points, Iran can be hopeful of rationalizing its pricing system in the long term while averting the adverse consequences of any kind of shock therapy as well