

Targeting Subsidies Considering the Applied Models in Iran

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Abstract

Iran's economy has suffered from chronic problems for decades and despite previous governments acknowledged those problems, no serious measurement was taken for economic reform. This remained unsolved until the ninth government, being aware of the basic problems of the economy in the country, designed a basic plan for economic reform a part of which was the comprehensive plan to reform subsidies payment. The project of targeting subsidies, which was the most important programs among the government's economic programs for 2010, dealt with people. The major advantage of targeting subsidies was correcting relative prices which was an important guide to individual consumers for deciding which type of commodities to use. Of other major advantages of this plan were social objectives such as an expected change in the distribution pattern of subsidies. In this paper it is tried to study various viewpoints and models of targeted subsidies in Iran. In this respect, the overall shape of the experimental and scientific models of targeted subsidies studied in Iran will be reviewed.

Keywords: subsidy, Iran, model, targeted, applicatory

1. Introduction

The Iranian targeted subsidy plan also known as the subsidy reform plan was passed by the Iranian Parliament on January 5, 2010 (Press TV, 2010). The government has described the subsidy plan as the "biggest surgery" to the nation's economy in half a century and "one of the most important undertakings in Iran's recent economic history" (finance.yahoo, 2010, Press TV, 2010 & Bahar, 2008). The goal of the subsidy reform plan is to replace subsidies on food and energy (80% of total) with targeted social assistance, in accordance with Five Year Economic Development Plan and move towards free market prices in a 5-year period (Press TV, 2010). The subsidy reform plan is the most important part of a broader Iranian economic reform plan.

The stated goal of the subsidy reform is "to rejuvenate Iran's economy, increase productivity, give it a new footing and bring it out of the slump it has been in for so long" (Tehran Times, 2011). Concrete consequences of the economic reform plan are that Iran will be less vulnerable to UN sanctions because it will reduce fuel imports (The Economist, 2011 & Tehran Times, 2011). The reform plan will also save money for the Iranian people because it will end a multi-billion dollar-a-year contraband (17% percent of fuel production in Iran is smuggled abroad daily) (Presstv.com. 2009, RAND Corporation, 2010 & IMF, 2010). Due to subsidies, Iran had long had one of the cheapest gas prices in the world, 10 cents per liter or 40 cents per gallon (RAND Corporation, 2010). Implementation of the plan will reduce waste and consumerism. In fact, according to official data, the higher income strata of the population has enjoyed the same subsidies as the poor until now (Tehran Times, 2011).

On the other side, subsidies reduction will reduce air pollution by reducing car traffic in Tehran (Tehran Times, 2011).¹ Finally, the subsidy plan will increase social justice through targeted social assistance (Go.worldbank.org 2010). According to official data, the richest deciles of households benefits 12 times more from gasoline subsidies than the poorest deciles (Press TV, 2010). Overall, implementation of the plan will increase productivity, efficiency, competitiveness of Iran's economy, economic growth, oil exports and per capita income (IMF, 2011).

2. A review of the income distribution in Iran in 2009 before targeting subsidies

In order to analyze the unequal level of income distribution, various criteria can be used. Gini coefficient and the indicator of relative share of income stratum are of the most important criteria in this regard. Table 1 shows the process of Gini coefficient and the share of the cost stratum from GDP per capita of urban and rural during 2005-2009.

Table 1 -. The Gini coefficient process and the share of the cost stratum from GDP per capita of urban and rural during 2005-2009

Year	Urban					Rural				
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009
Gini coefficient	0.4061	0.4165	0.4120	0.3904	0.3903	0.3896	0.4019	0.3923	0.3792	0.3831
The 1 st stratum	0.0227	0.0215	0.0214	0.0234	0.0229	0.0236	0.0235	0.0238	0.0250	0.0177
The 2 nd stratum	0.0357	0.0338	0.0334	0.0373	0.0383	0.0371	0.0361	0.0374	0.0390	0.0336
The 3 rd stratum	0.0455	0.0441	0.0446	0.0447	0.0502	0.0473	0.0459	0.0475	0.0492	0.0457
The 4 th stratum	0.555	0.540	0.549	0.0576	0.0607	0.0557	0.0559	0.0570	0.0590	0.0571
The 5 th stratum	0.0659	0.0647	0.0659	0.0684	0.0732	0.0691	0.0666	0.0677	0.0699	0.0695
The 6 th stratum	0.0786	0.0778	0.0786	0.0812	0.0860	0.0817	0.0792	0.0804	0.0825	0.0695
The 7 th stratum	0.0953	0.0948	0.0954	0.0974	0.1038	0.0975	0.0975	0.0973	0.0980	0.1008
The 8 th stratum	0.1192	0.1198	0.1196	0.1207	0.1262	0.1207	0.1185	0.1199	0.1197	0.1246
The 9 th stratum	0.1602	0.1629	0.1612	0.1597	0.1615	0.1590	0.1593	0.1580	0.1558	0.1639
The 10 th stratum	0.3215	0.3267	0.3240	0.3067	0.2778	0.3063	0.3192	0.3019	0.3019	0.3033
Share of the 20% of the poorest population	0.0584	0.0553	0.0558	0.0607	0.0616	0.0607	0.0596	0.0612	0.0640	0.0513
The ratio of the share of the 10% of richest population to the 10% of the poorest population	17.06	12.09	13.06	13.57	12.97	12.12	13.13	15.17	15.21	14.15
The ratio of the share of the 20% of richest population to the 20% of the poorest population	9.09	7.15	7.66	8.02	7.66	7.12	7.69	8.69	8.86	8.25

Source: Statistical Center of Iran

3. Subsidy of basic commodities

In table 2, The subsidy of basic commodities and its share is observable in some fiscal and economic variables at current and fixed price from 2005 to 2009.

Table 2: The subsidy of basic commodities and its share in some fiscal and economic variables at current and fixed price (1997=100)

Year	The subsidy of basic commodities at current price (billion Rials)	The subsidy of basic commodities at fixed price (billion Rials)	The ratio of the subsidy of basic commodities to the State's general budget (percent)	The ratio of the subsidy of basic commodities to the tax incomes (percent)	The per capita of subsidy of basic commodities at current price (Rials)	The per capita of subsidy of basic commodities at fixed price (Rials)
2005	51830 (24.8)	16849.8 (11.4)	11	38.5	746830 (22.8)	242793 (9.6)
2006	57663 (11.3)	16440 (-2.4)	10	38	815007 (9.1)	233192 (-4)
2007	57198 (-0.8)	13822.6 (-15.9)	9.1	29.8	799972 (-1.8)	193323 (-17.1)
2008	58663 (2.6)	11648.8 (-15.7)	7.3	24.5	808035 (1)	160451 (-17)
2009	68617/(17)	12229 (5)	8.1	22.9	932297 (15.4)	166155 (3.6)
Average	58794.2 (10.6)	14198 (-4.2)	9.1	30.7	820428 (8.9)	199182.8 (-5.6)

4. Subsidy of basic commodities In Iran in the year 2009

Table 3 shows the combination of governmental funds and the subsidy allocated to the basic commodities in Iran in the year 2009.

Table 3. The combination of government subsidy funds in 2009

	Explanation	subsidy amounts approved in the budget law (billion rials)	subsidy payments function (billion rials)
1	Subsidy of commodities such as wheat, milk, oil, rice and sugar	42972.5	45007.9
2	Subsidy of agricultural inputs and production factors, animal feed and rural breeding reform	9022	11222
3	Loss of oilseed purchases guarantee	885	1685
4	difference in determined and assigned price of commodities and services - Article 39, paragraph (c) in 4 th development projects 4/1240	2650	901550
5	Department of Commerce - Market regulation	500	1939.8
6	Specific commitments for basic commodities of executive systems (cash)	3500	3870
7	subsidy formula and medicine and health, metabolic and emergency drugs	3200	3200
8	support of cancer and specific patients and to help meet the expenses for patients with intolerable costs and indemnities hemophiliacs	600	452
	Total subsidies for basic commodities	63329.5	68617
9	Grants, subsidies of interest and wages, administered funds of education and supervising implementation of production and services projects oversee the manufacturing and non-profit higher education	1260	0
10	Margin guaranteed purchase price of water from the private sector	100	66.2
11	Grants, subsidies of profit and wages of mosques and on the way toilets	250	126
12	Projects to develop public transport fleet and fuel consumption management	2350	1218
13	Projects to complete comprehensive studies of transport and traffic and public transportation development in metropolises	1500	466.6
14	Subsidy of installation of new electricity split	40	16
15	Grants, subsidies, interest and wages for facilities and managed funds for Mehr housing	3000	1552
16	Helping the implementation of rural projects	2012.1	845
17	Farhangian Housing subsidies	400	230.4
18	Department of Health – subsidized of drugs special diseases	1000	0
	Total subsidy	75241.6	73137.3

Source: 2009 Budget Law and the State Treasury

5. Government budget

Iran's oil and gas projected revenues by the International Monetary Fund. Iranian officials estimate that Iran's annual oil and gas revenues could reach as much as \$250 billion by 2015 (Mehr News Agency, 2010).

According to the 2010 draft budget, the government is planning to generate \$40 billion by 2011 from the reduction or removal of subsidies – as opposed to the \$20 billion authorized by the law during the first year. On March 8, 2010, the Iranian Parliament approved a \$347 billion budget. In the same budget, the allocation from subsidies and the oil price were set at \$20 billion and \$65 per barrel, respectively (Derakhshi (2009). President Ahmadinejad has proposed holding a referendum on this subject. As a compromise, the Iranian Parliament has granted Ahmadinejad's government the freedom to disperse the yearly subsidies in a shorter period of time (6–9 months). According to the Vice President for Parliamentary Affairs, Iran's subsidy reforms would save 20 percent of the country's budget. As of November 2011, the Government reported that the subsidy reform plan has saved Iran \$6 billion (Tehran Times, 2011). Table 4 and 5 show the government budget in different sectors.

Table 4: IMF Projections/Scenarios

	as at 2008/09	2014/15 Baseline	2014/15 Energy price reform
Real GDP growth	-3.7%	3.5%	~8%
Real GDP growth (non-oil)	2.9%	3.8%	~8%
Crude oil exports	2.4 Mb/d	1.8 Mb/d	~2.5 Mb/d
Current account	7.2%	0.2%	~2.5%
CPI inflation	25.4%	10%	~7% (peaking above 30% in 2011)
Gross official reserves	\$80 billion	\$98 billion	~\$170 billion

Source: Mehr News Agency (2010)

Table 5: Overview of 2011–12 budget and comparison with 2010–2011 budget.

Item	2011–12	2010–11	% Change
General Budget, of which	170	129	31.8%
Development Expenditure	35	31.7	10.4%
General Expenditures & Other Items	135	97.3	38.7%
Budget for State-Owned Banks and Enterprises	355	252.5	40.6%
Total*	508	368.4	37.9%
Resources from Subsidies Phase Out	54	20	171.7%

* Totals may not add up due to rounding and deduction of double-counted items Note: all numbers are in billion dollars.

Source: Turquoise Partners, (2011)

5. Conclusion

Many experts believe subsidies payment in the Iranian economy in the current method is the root of many economic problems and reforming it can the economy and provide easier living conditions. The former government also repeatedly raised the need to reform it, but not a practical measurement was taken in this regard. The ninth and tenth governments have long aimed to make fundamental change in the Iranian economy and determined to implement serious structural reforms in this respect.

Historical review of subsidies in the economy has indicated that in the higher income stratum gain the most subsidies, particularly subsidies to energy. Generally a sum of over \$600 billion has been paid for energy and continuing this method, will certainly end in an increase in the figure and even with the oil costing \$100 it will increase to about \$2000 billion. Formerly, because there was little difference between market prices and the price that government policy had set, the amount of subsidy in the budget was not much considerable. Of course, the subsidies paid in the decades of 50 and 60 in the economy of Iran are quite different from the subsidies today in terms of size, structure and allocation. Sometimes subsidies were allocated to basic commodities including rice, meat, eggs, flour, oil and sugar, etc. and sometimes to energy. However, today we see that the basic commodity subsidy has reduced in compare with energy subsidy and this difference is often due to the difference between international and domestic energy prices.

Another point to consider is that after the implementation of targeted subsidies and paying the subsidies in cash, some problems may be caused in the society, but with implementation of such a great project, many problems will be solved in Iranian economy. However, its implementation requires a national and public determination and contribution. One of the bases of success of this project is its acceptance among the elite, the three legal branches and experts.

It seems today we are seeing a constructive interaction between the chains. Perhaps one reason the previous government failed to act in this project was the absence of interaction between elites, authorities and people. But nowadays a lot of such contradictions and gaps are filled and all elements of the society contribute and interact to implement and advance this project.

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