Iran's Subsidies Reform

Mitigation Measures to Protect the Poor

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Agenda

- An overview of reform process
  - Justifications for reform
  - Targeted Subsidies Reform Act 2010
  - Mitigation measures
- Reform implementation: initial success
- International sanctions
  - Overall economic implications
- The impact of sanctions and mismanagement
- Concluding remarks

Justifications for Subsidies Reform

- Reduce onerous burden on the budget resulting from rising oil prices (US$80 billions in 2010);
- Discourage wasteful energy consumption;
- Distribute national wealth fairly and equally;
- Optimal resource allocation;
- Prevent fuel smuggling;
- Diminish impact of international sanctions;

Targeted Subsidies Reform Act 2010

- **Gradual** increase of energy prices within a 5-year period (2010-2014);
- Retail price increase of ‘no less than (& no more than) 90% of FOB Persian Gulf prices’ for petrol, diesel, fuel oil, kerosene and LPG;
- Increase of natural gas retail prices to 75% of its average export price deducting transmission costs and export tax;
- Government bears up to 25% international market price increase;
- US$10-20 billion revenue in the first year of reform;

Mitigation Measures

- Payment of **Maximum** 50% of the fiscal revenue to population in forms of :
  - In-cash and in-kind;
  - Social security programmes;
- Payment of 30% to industries and producers;
- Payment of 20% to government to cover rising costs;

Reform process: initial success

<u>Reasons</u>

- Strong political willpower to reform subsidies;
- Establishing trust: effective communications; cash deposited in individual's banks account before the start of the reform;
- Well-organised pre-reform preparations to attract support:
  - Reform literature: 'targeting ≠ eliminating';
  - Generous nation-wide cash payment of IRR 4550,000 or US$45 (in 2010 exchange currency rate); equal to 10% of minimum monthly wage;
- Excellent communication strategy and extensive public relation campaign;
- Fast and efficient upgrade of banking infrastructure, particularly in rural area, to handle nation-wide compensatory payments;
- Reform timing;
- Government orchestrated market intervention to prevent public panic;

Reform process: initial success

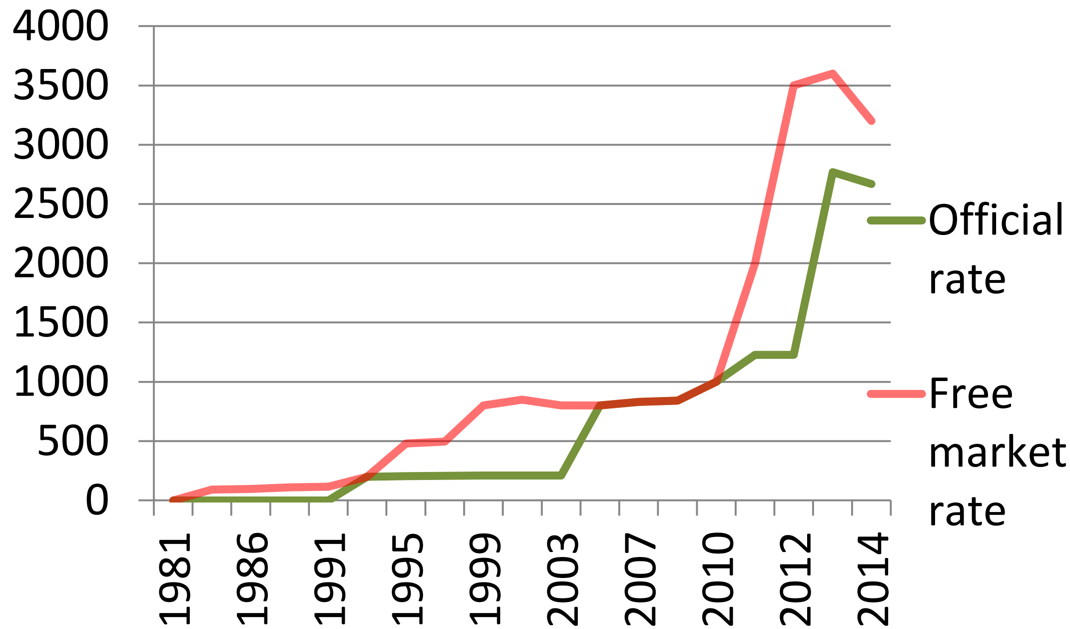
<u>Implications:</u>

- The balance of cash transfer in favour of households;
- The program pro-poor and pro-equity;
- 5% decline in poverty rate mostly in rural areas in the first year of the reform;
- Decline in indicators of inequality;
- Cash payments and increase in market liquidity and hence mild inflation;
- Reduction in the consumption of most energy variables;

2012 international sanctions: economic implications

Sanctions targeted:

- Iranian Central Bank
- oil export



➢ **300% devaluation of the national currency**

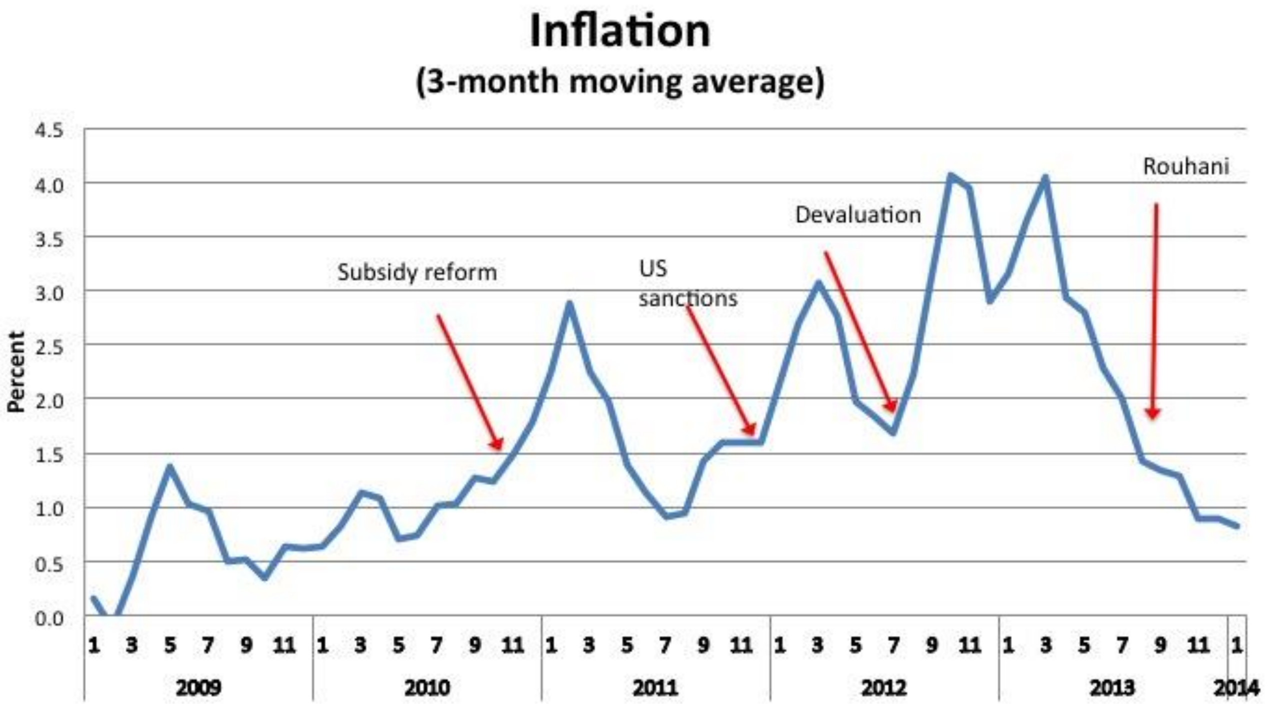
IRR455,000

US$45 (in Dec 2010)

US$13 (now)

2012 International sanctions: economic implications

- **over 55% inflation**
  - Rising liquidity (increase of purchasing power
  - Higher cost of production
  - Restricted access t foreign exchange reserves;



Source: Salehi (2014)

The impact of sanctions and reform mismanagement

- In the face of rising inflation and devaluating currency:
  - The value of transferred cash reduced;
  - A large portion of subsidies crept back to the market;
  - Increase in energy consumption and smuggling;
- In the light of reduced government revenue, government was forced to print money, hence further inflation;
- To keep up with the monthly cash payment, the government tabbed into the investment funds of development projects and industries’ share of the reform (business downgrade or bankruptcy) ;
- Increase in poverty and social inequality

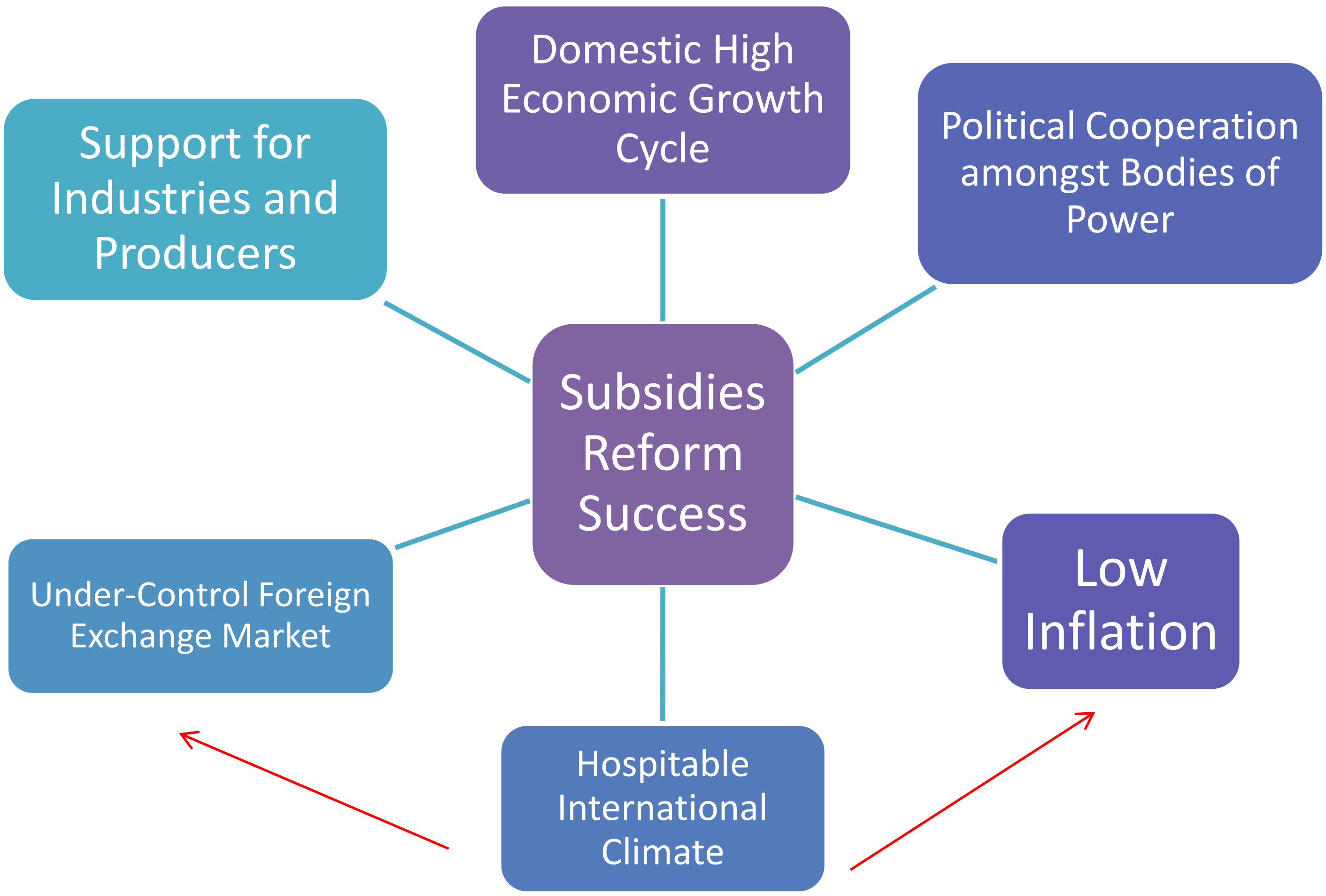
2nd phase of the reform

- Implementation started in March 2014, by the Rouhani Government: further energy prices increase of 20-25%;
- Calls on people to volunteer to decline receiving cash payments: only 2.4 millions
- Attempts underway to eliminates non-needy ones: yet no systematic mechanism in place;
- For others, more investment in infrastructure;
- Allocate more revenue to industries and infrastructure improvement: job creation, economic growth, less inflation, etc.

Concluding remarks: Iran's experience of poor protection

- In an oil exporting country, subsidies reform to a large extent is influenced by external variables: prices of oil, international politics and etc;
- Availability of right infrastructure : data collection, national survey, etc.
- Cash payments an interim remedy to gain trust in order to launch the reform; they should later only target eligible households;
- Mitigation measures should focus more on in-kind remedies: national health services, education, infrastructure development, pension funds, and etc;

Concluding remarks: Iran's experience of poor protection



Thank You

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