

# ***ENERGY SUBSIDIES REFORM IN IRAN: AN EXAMPLE FOR THE WORLD?***

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## **Overview**

A global significant force is emerging to cut or modify energy subsidies. An important example is the Group of Twenty 2009 summit, where major economies committed to "reduce fossil-fuel subsidies while preventing adverse impact on the poorest" (World Bank 2010), a commitment that was followed up by Asia-Pacific Economic Cooperation leaders in the same year (Beaton et al. 2013). According to the 2014 World energy outlook (IEA 2014), at least 27 countries among the 40 fossil-fuel subsidized economies have implemented partial reforms. Although such claims for reform have been established, the International Energy Agency's (IEA) latest estimate (IEA 2014) indicates that the amount of world subsidies directed to fossil fuel consumption only in 2013 is around \$550 billion. According to an estimation by the International Monetary Fund (Clements et al. 2013), only removing energy consumption subsidies could result in a 13% decline of the world CO<sub>2</sub> emissions. In addition to environmental incentives, removing such subsidies may release a great portion of countries' national budget for more productive targets.

One of the most recognized challenges of this promising reform is selling the new energy prices to citizens, particularly those who have a more fragile purchasing power. Several empirical and technical research, partly acknowledged by international organizations, have prescribed the reform supported by a direct compensation mechanism to be feasible enough to raise the necessary public support. As partially reflected by Ellis (2010), energy consumption subsidies are particularly prevailing in developing countries where there is not a reliable and updated information infrastructure about household income. In addition, a discrimination in compensatory paybacks may induce citizens to understate their income, or even provoke them into positioning against the reform. In that context, a convenient solution could be a lump-sum direct deposit to all consumers, as proposed by Jensen and Tarr (2003). Having studied the case of Iran, these authors claimed that, even if the reform revenue were to be redistributed equally among households, the average welfare would increase considerably.

That claim confers to the ambitious reform launched by Iran in December 2010 when the most energy-subsidized economy to date decided to adjust dramatically its low-priced energy carriers. To avoid making the millions of low-income households suffer from this reform, the government committed to a direct deposit to all households, a provision that was also acknowledged by international organizations (Moshiri 2015). The peaceful acceptance of the reform by all income classes was beyond even the most optimist predictions. However, after a smooth beginning, a number of difficulties were encountered and consequently the second phase of the reform was temporarily postponed. These difficulties, ranging from excessive national budget deficit to extraordinary inflation and devaluation shocks, raised some important doubts about the prescribed reform.

## **Methods**

Case study

## **Results**

First, the context of Iran's case including economic & political drivers, ultimate reasons for reform and different obstacles it faced are presented.

Second, various approaches that have been used by Iranian policy makers to modify the challenging risks of such reform are examined with regard to international strategies.

Finally, key factors of success in future planning and implementations of such reforms in Iran and similar cases are discussed.

## Conclusions

The main target of any energy subsidies reform is to decrease the gap between the subsidized price and reference price. As elaborated in the case of Iran, reference price is directly dependent upon the international prices and the local currency exchange rate. While those factors evolve over the time, underestimating the dynamics of the reform may wash out any short-term realization. For instance, the international oil price is rather exogenous but the local currency exchange rate is highly correlated with local inflation and of course the reform process. The latter endogenous issue is particularly related to how the reformist government redistribute the released income of the reform. Finally, a strong intention to phase out energy subsidies supported by a comprehensive plan seems crucial but not sufficient. This may partially violate the idea that modifying a distorted market has a clear path in the literature of regulation. Although a few achievements of this reform have appeared beyond predictions but some noteworthy Achilles' heels are illustrated for further theoretical and empirical research.

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