

Government Subsidies in Iran

(The case of Gasoline)

By

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Who am I

- My name is Roozbeh Hosseini
- I am a second year PhD student in Department of Economics
- I am interested in issues regarding Government Policies and their effect on Economic Growth, Wealth Inequality, Welfare, etc.

My Country



- I am from Iran
- My country is in the Middle East (right between Afghanistan and Iraq)
- The ancient name of Iran was *Persia*
- The official language is *Persian (Farsi)*
- The Capital is *Tehran*

A broader look



Some facts about Iran

	Population (Million person)	Area (million sq km)	Per capita income (US Dollar)
Iran	65.619	1.648*	2000
U.S	293.027	9.631	37610
Minnesota	5.059		23198

* Almost the size of Alaska

- Political system is *"Islamic Republic"* since 1979
- Iran does not have any diplomatic relationship with U.S.
- The conflict between two country started after *hostage crisis's* incident

More Facts

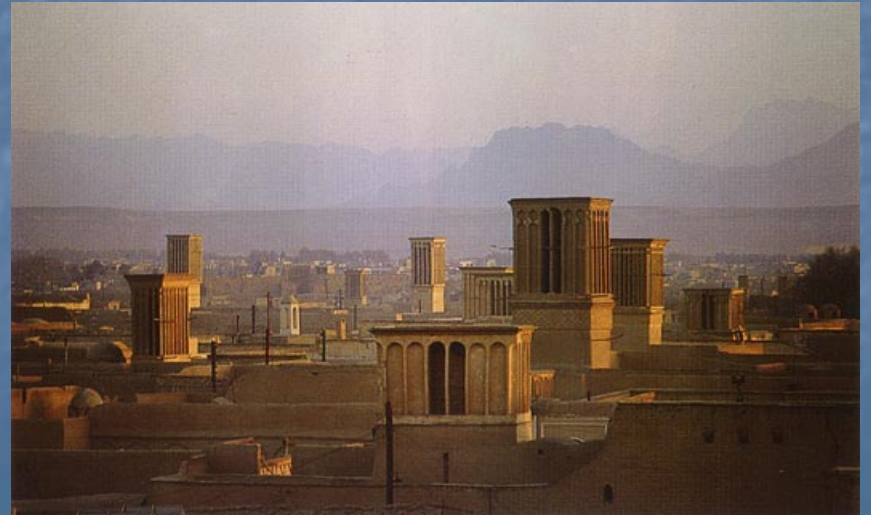
- Iran is a member of OPEC
- With Crude Oil production of 3742 *Barrel per Day* , Iran is the second largest member (after Saudi Arabia)
- Revenue from Oil export is almost 15% of national income
- Oil revenue is also the main source of income in government's budget

Social environment

- Iranian society is a mixture of tradition and modern life



Geographical Environment



Economy

- By its constitution, government of Iran controls major economic activities.
- In particular, government is the only producer and supplier of gasoline
- Price of gasoline is determined through a beurocratic procedure
- Each year, government announces the price at which it sells gasoline

Some price comparison

	1993	95	98	2000	2002
Crude oil (world market)	42	42	26	76	61
Gas (normal sales price)	98	98	83	140	121
US	121	129	121	178	151
UK	n.a.	348	420	443	446
Germany	n.a.	424	363	344	390
Iran	n.a.	n.a.	30	19	26

- All prices are in *U.S cents per Gallon*
- *Normal sales price* is hypothetical sales price for refined and distributed PETROLEUM FUEL, if it were sold as a normal commercial commodity e.g. MINERAL WATER. Therefore, if Gasoline is sold at a higher price, it is being taxed. If it is sold that lower price it is being subsidized
- Source: www.internationalfuelprices.com

As a result

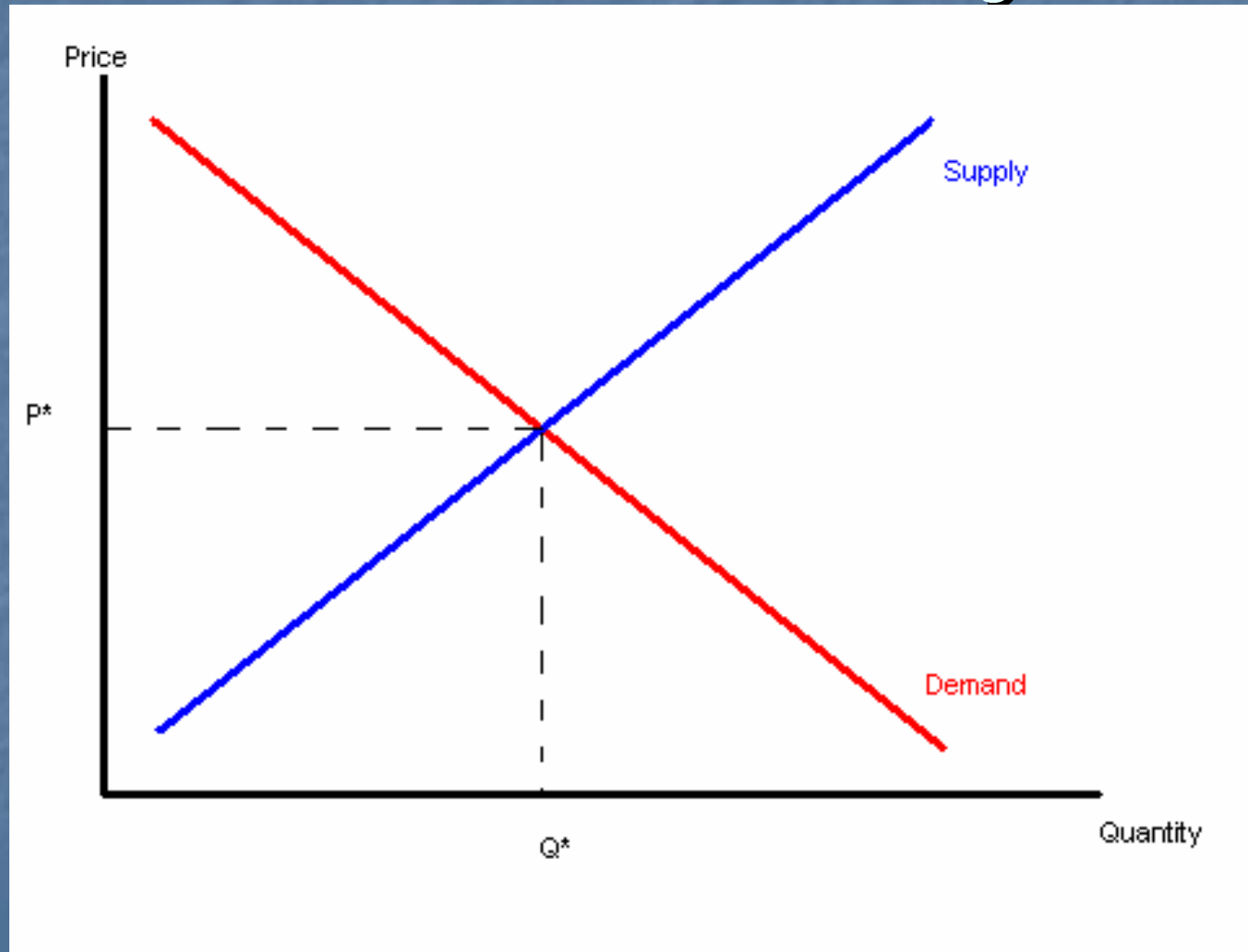
- Gas consumption is growing at 6.4% per year
- Tehran is one of the most polluted cities in the world (in terms of air pollution)
- Financial burden for government



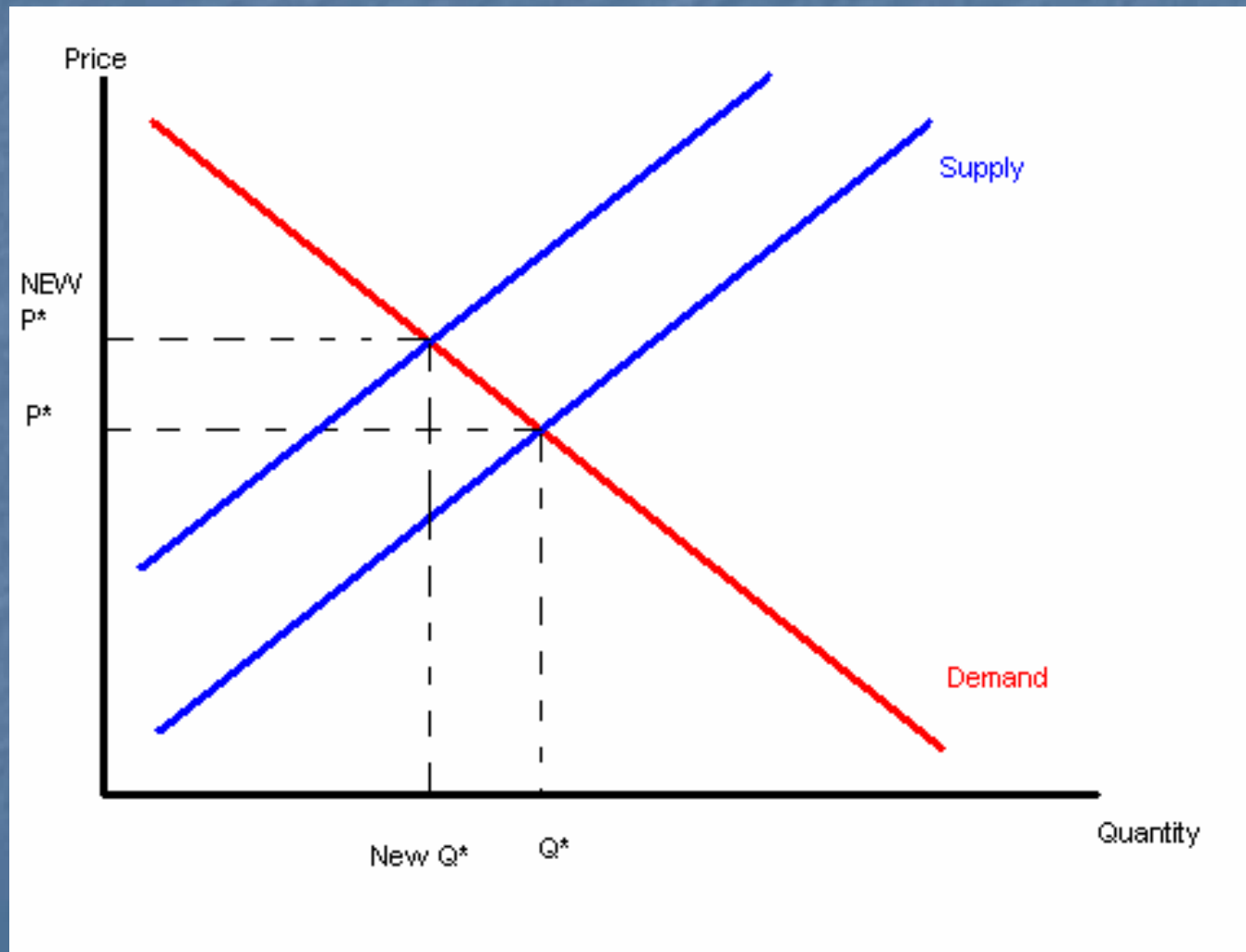
Why government does that?

- When faced with this question, lawmakers often mention three reasons:
 - Improving Social justice
 - Arguing that gas is a very important commodity. Increase in price of gas will affect the price of all other goods
 - Lack of belief in market system (market means chaos!)
- But in fact it is mainly because of political reasons

Market Economy



Increase in Cost of Production



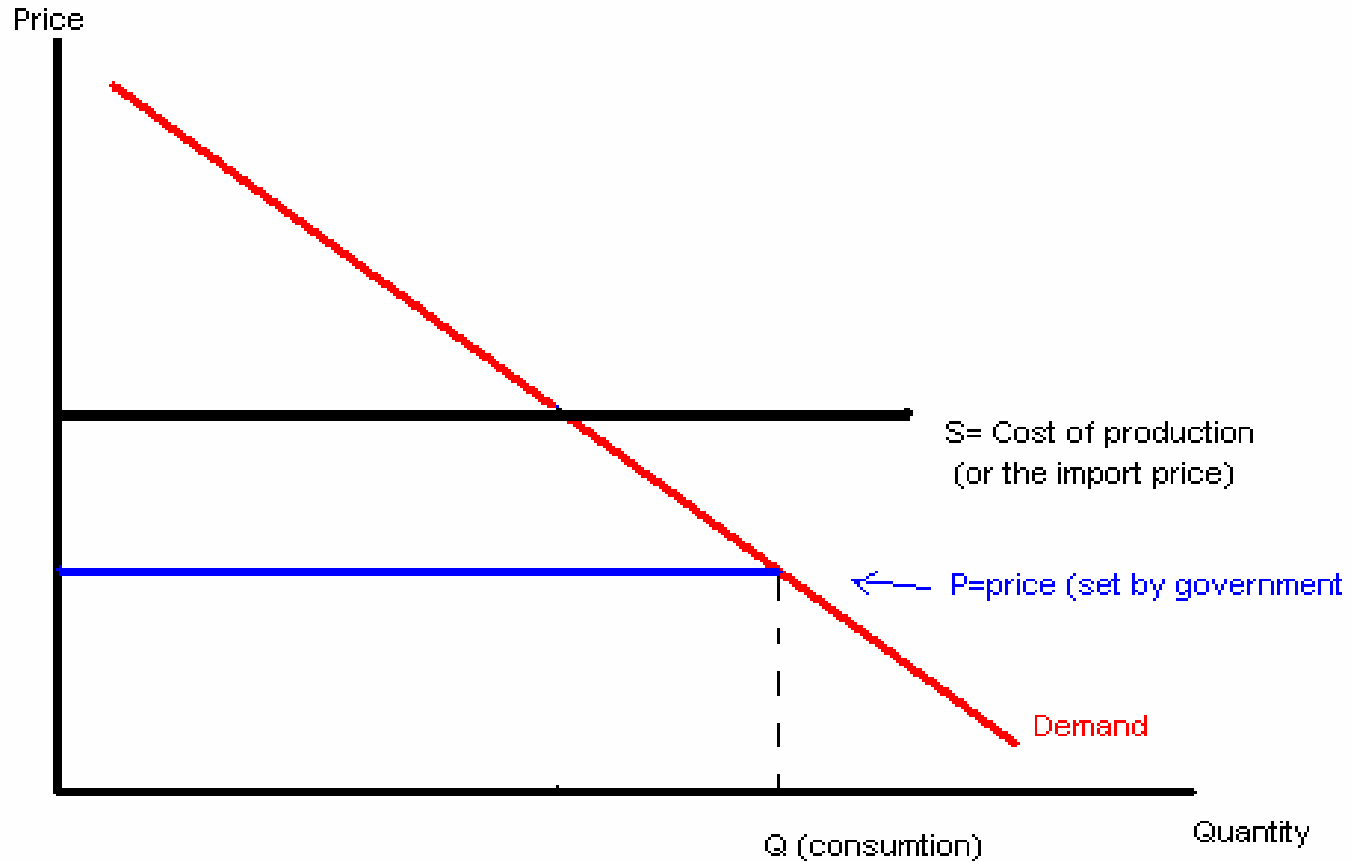
Market Economy

- Suppliers adjust their behavior
- This Adjustment reflects in the market
- Price goes up
- People adjust their consumption decisions
- Market clears
- Note: Outcome of the market is result of behavior of individual

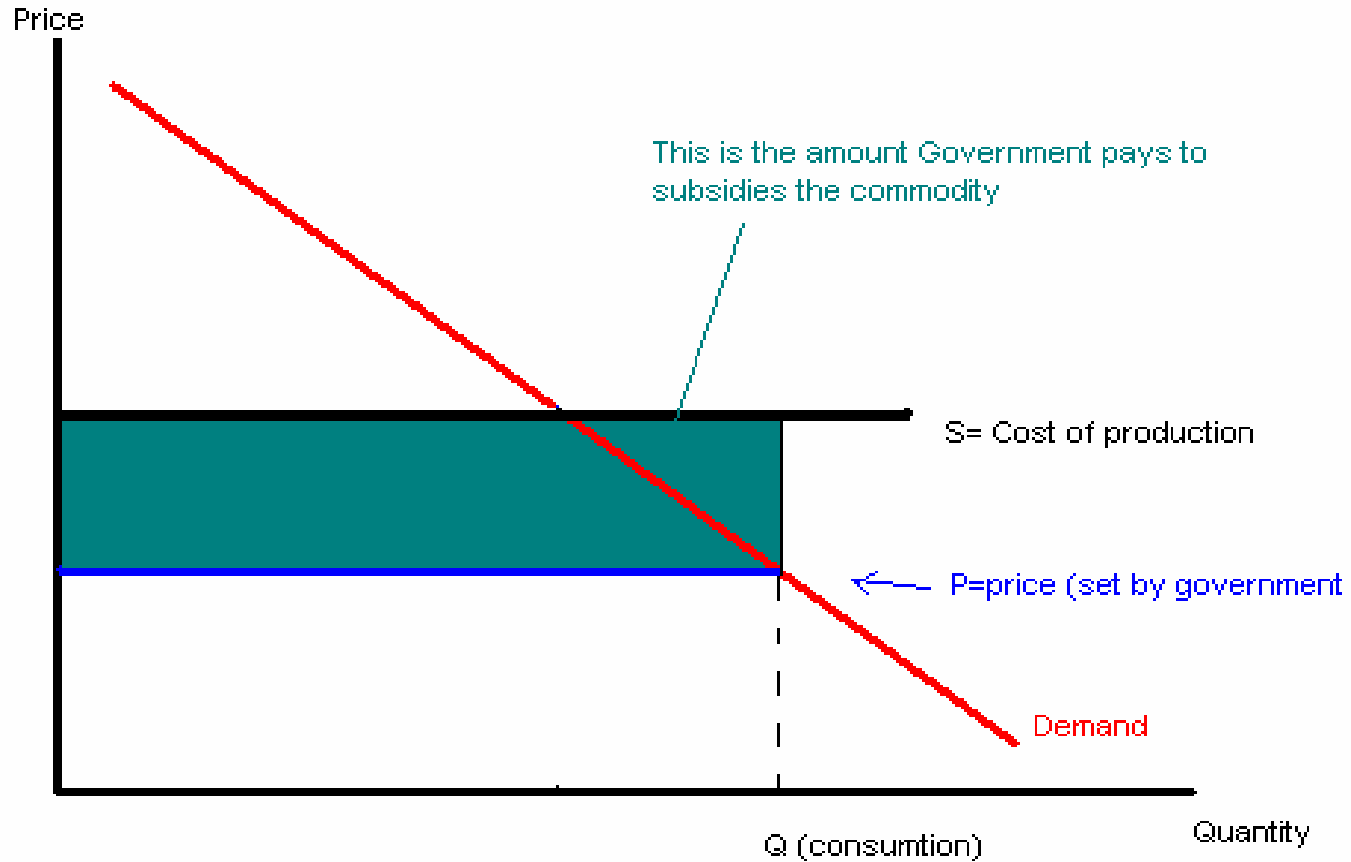
Non-Market Setup

- Government produce gasoline
- Suppose the opportunity cost of production is 'S'
- Gasoline is being supplied at a price lower than 'S'
- So on each unit being sold government is actually paying the difference between 'S' and the price

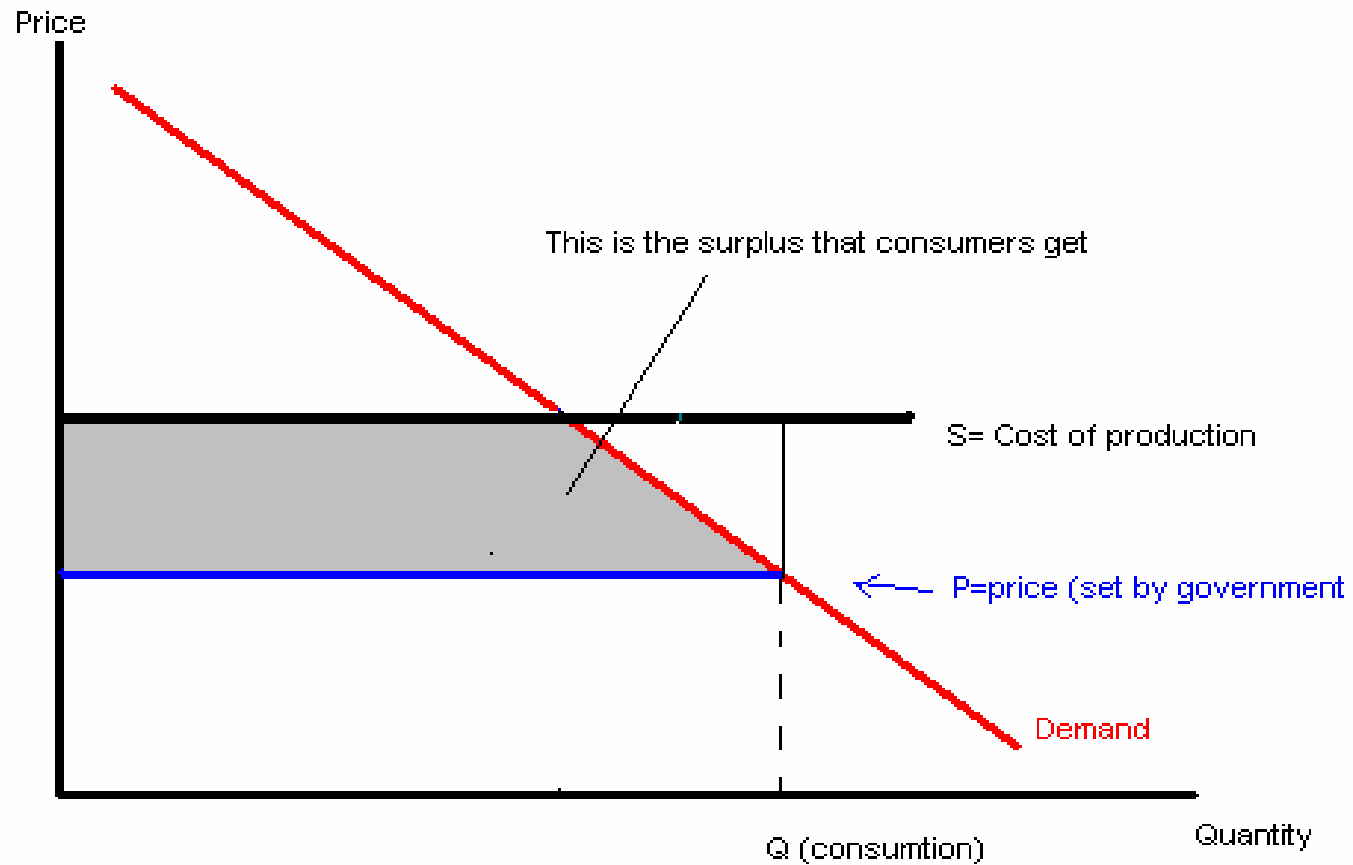
Non-Market



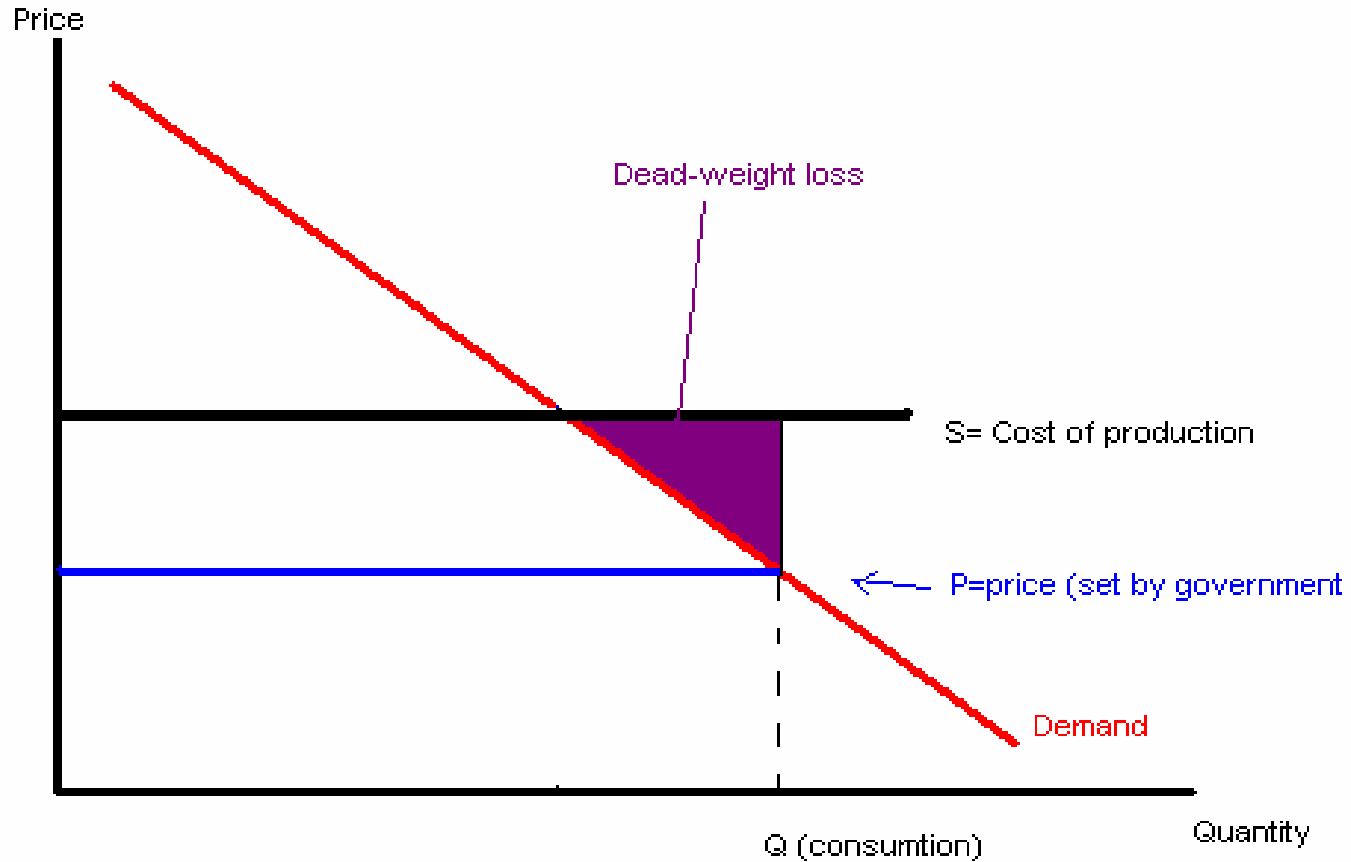
Who pays the difference?



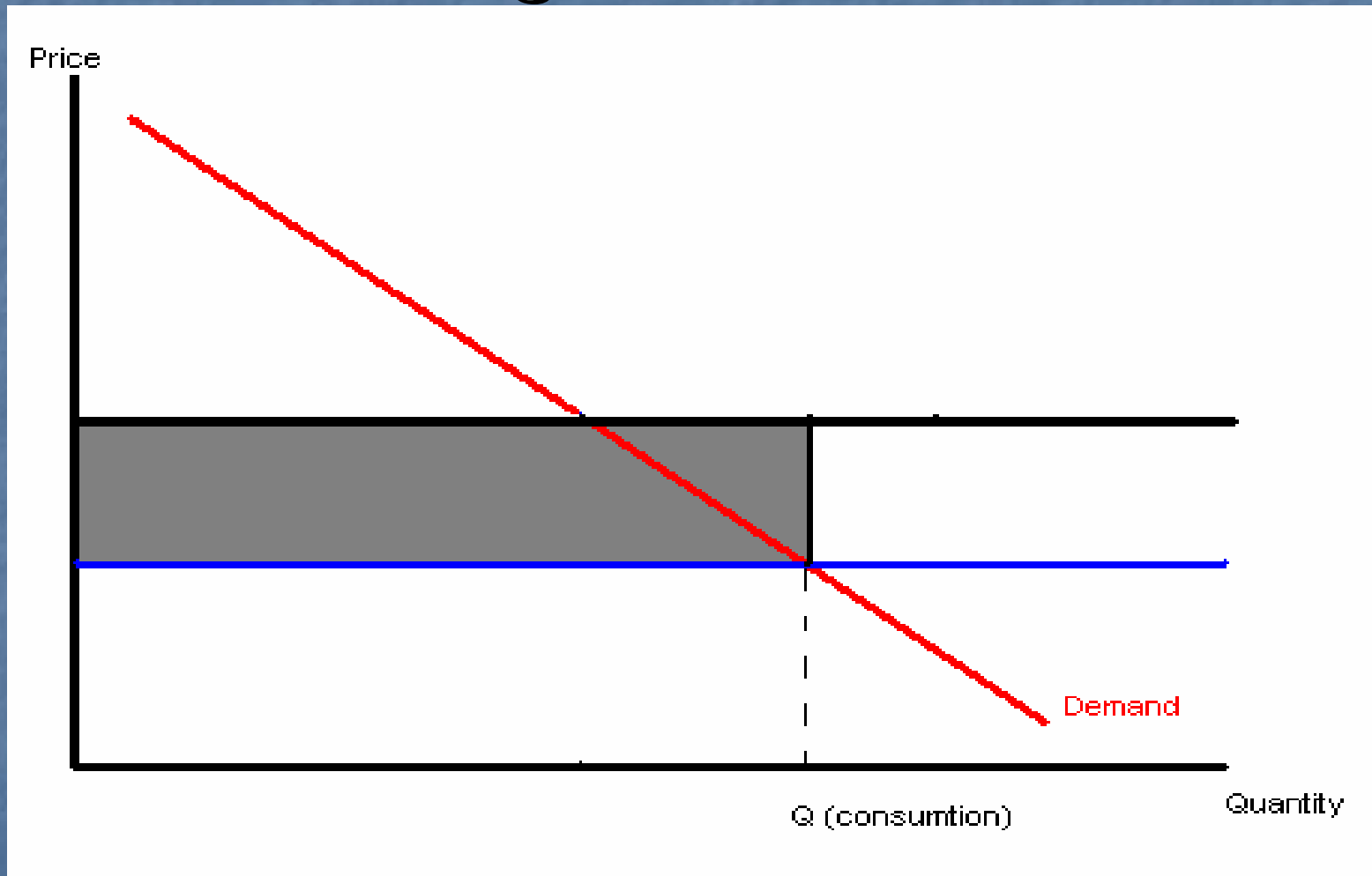
Who gets it?



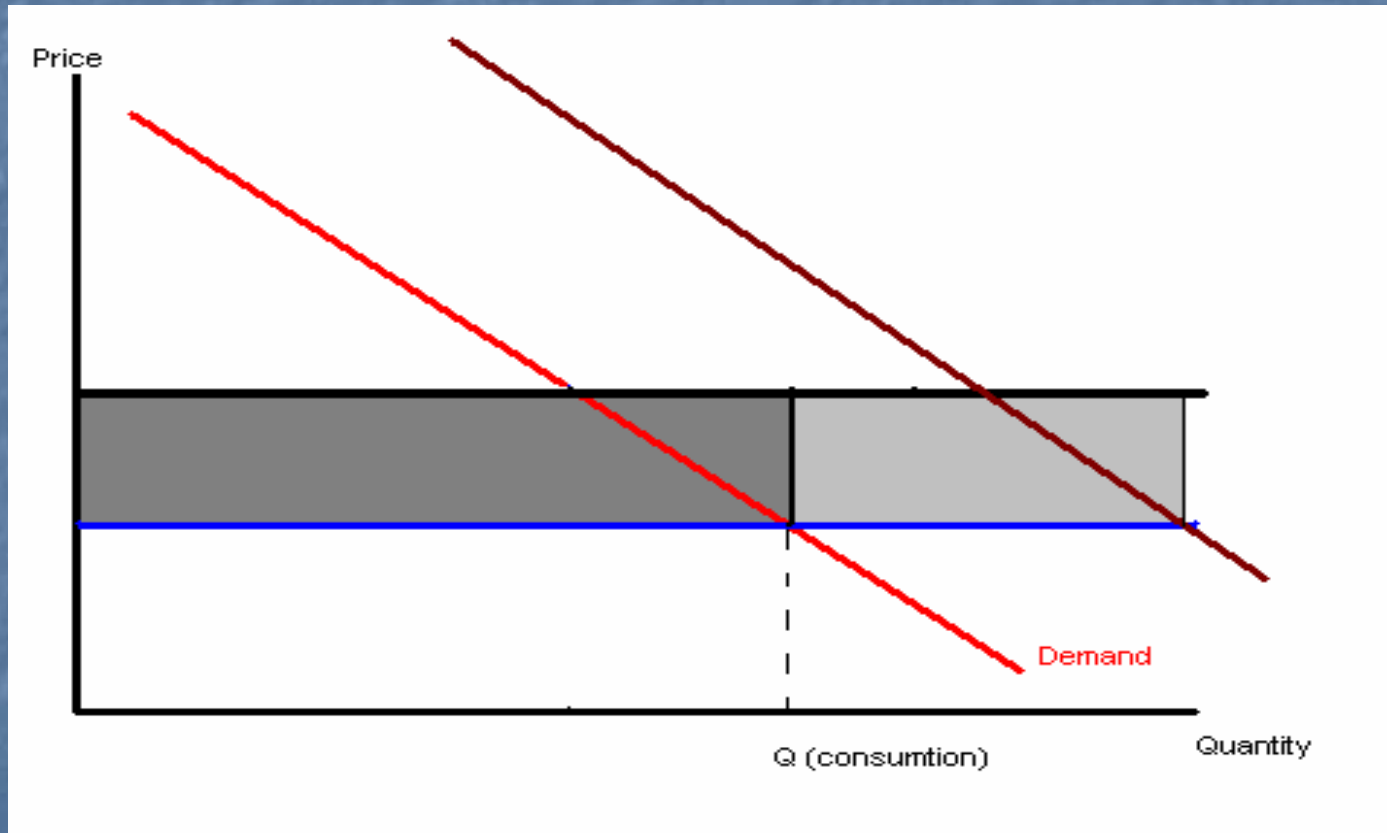
Who gets the rest of it?



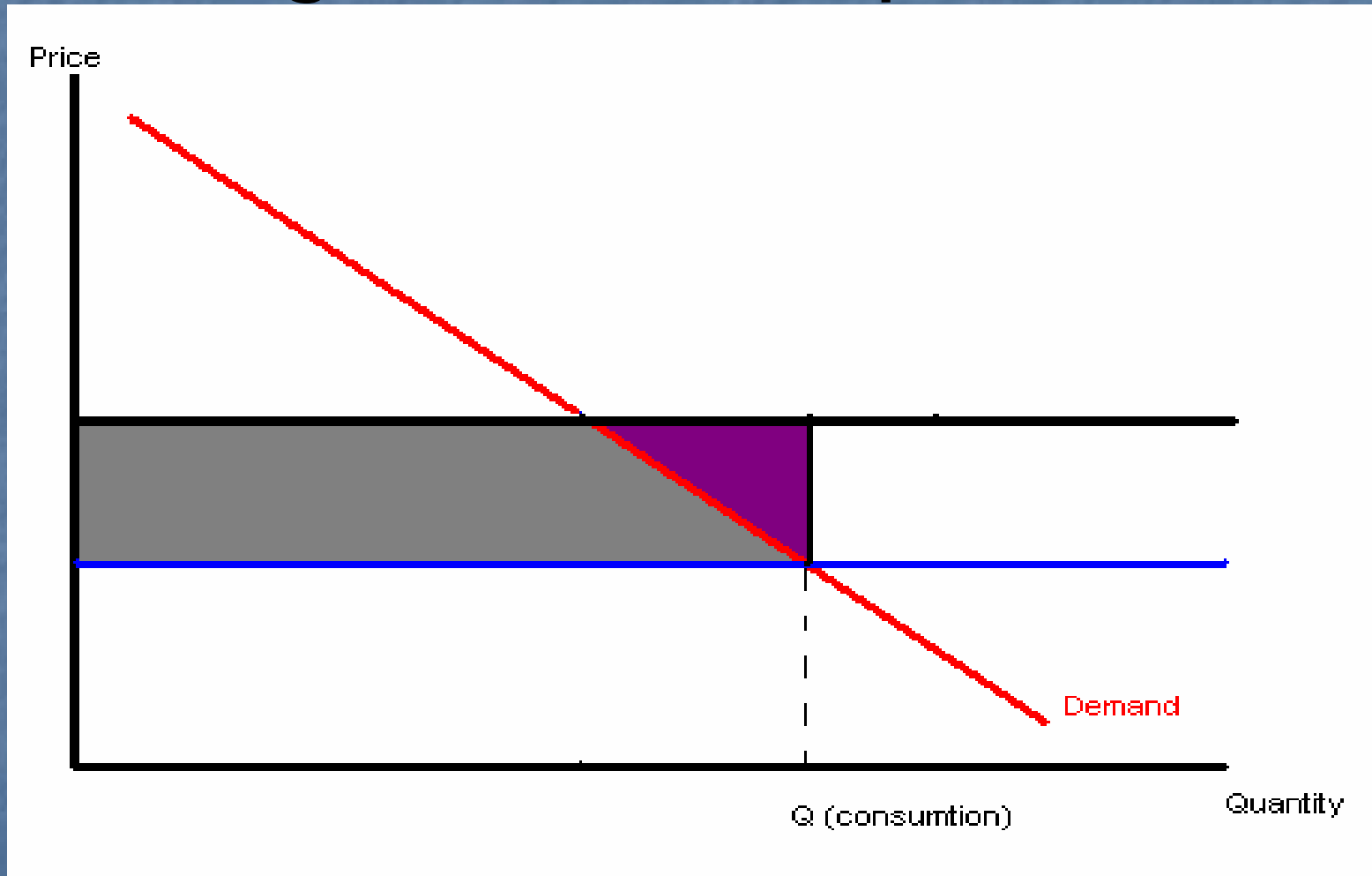
Change in demand



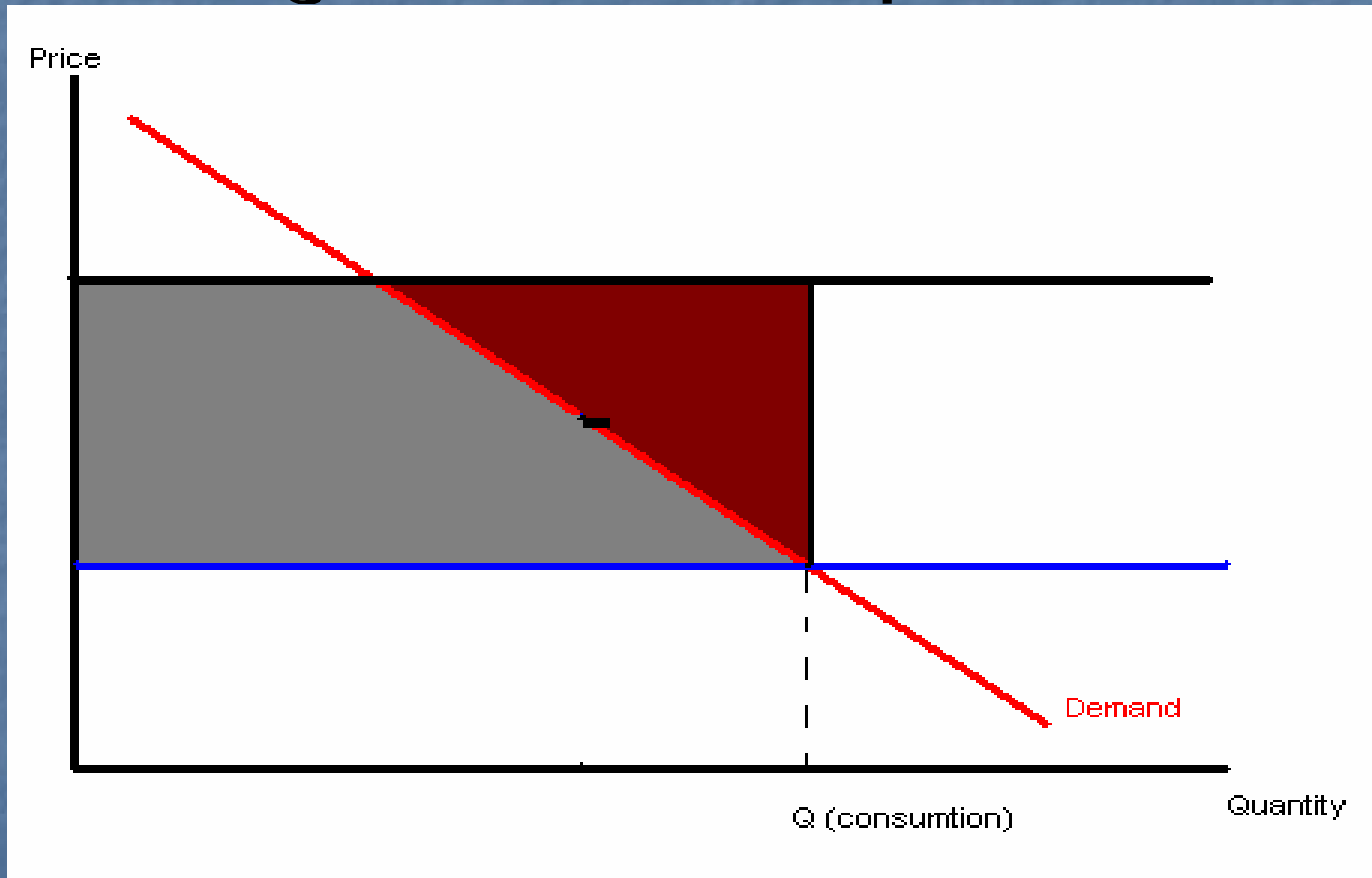
Change in demand



Change in cost of production



Change in cost of production



What's wrong with it

- Any changes in demand directly affect the amount that government has to pay
- Any change in cost of production directly affects demand as well as the dead-weight loss
- Who is '**really**' paying for this?!
- There is a dead-weight loss. That means whoever is paying for this. Part of it is lost, without anyone receiving it.

Who **really** pays for it?



Who receives it?



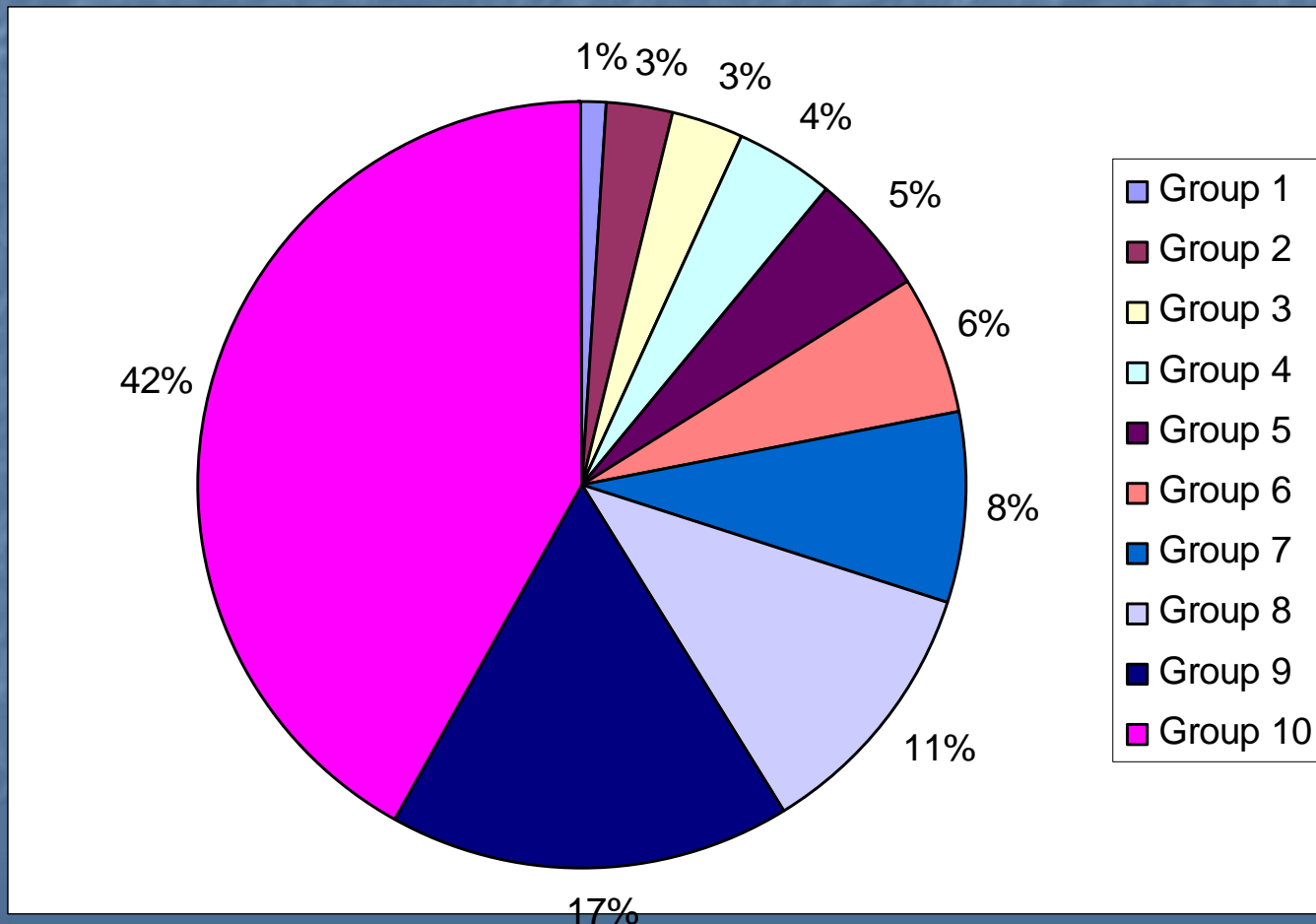
Where does it go?



What does data say about it ?

- Suppose we rank people according to their income
- Let's divide the total population into 10 groups of equal size (group 1 to 10)
- Let's group them so that people in group 1 have the lowest income and people in group 10 have the highest

How the subsidy is distributed ?



Is it surprising?

- No! if you consider the fact that in the lowest income group (group1) only 2.4 % own car. While 41.3 % of people in the richest group own car (and many of them own more than one)

So?

- Here you go ! This government spends a lot of money each year to provide subsidies with intention of improving social justice and helping poor people
- It creates inefficiency in Economy by generating dead weight loss
- It increases air pollution by making polluters so cheap
- Data shows that poor people do not get a share of this!!

Looking for more information?

- CIA factbook

<http://www.cia.gov/cia/publications/factbook/>

- OPEC

www.opec.org

- International Energy Price Information

<http://www.eia.doe.gov/emeu/international/prices.html>

- For more on fuel prices see

<http://www.zietlow.com/docs/Fuel-Prices-2003.pdf>