

Abridged by Adam Dempsey , Research Associate, U K Defence Forum, from an article, originally published by the New York Times on January 16th 2011, written by William Yong

Iran has embarked on a sweeping program of cuts in its costly and inefficient system of subsidies on fuel and other essential goods that has put a strain on state finances and held back economic progress for years. The government's success in overcoming political obstacles to make the cuts and its willingness to risk social upheaval suggest that President Mahmoud Ahmadinejad may have consolidated power after the internal fractures that followed his bitterly disputed re-election in 2009.

Analysts also believe that the successful implementation of the cuts could influence Iran's position at nuclear talks in Istanbul this month. "The initial success of the subsidy reform will increase the regime's confidence generally," said Cliff Kupchan, a former State Department official who is now a director at the Washington-based Eurasia Group. "This could make them more assertive in the talks. But more importantly, a confident and unified regime is better positioned to reach consensus on some initial agreement."

Secretary of State Hillary Rodham Clinton said recently that international sanctions had slowed Iran's nuclear program, and the restrictions do seem to have disrupted sectors of the economy, particularly banking and export-related industries. But the sanctions do not seem to be the driving force behind the subsidy cuts.

Iran's foreign exchange revenues also sank in recent years as oil prices fell from prerecession highs, creating greater budget pressures. But Tehran has long sought to cut the subsidies — even under the reformist administration of President Mohammad Khatami — and particularly for oil.

The logic is compelling: artificially low prices encourage greater consumption, leaving less oil to export for cash. And the higher oil prices rise, the greater the "opportunity costs" in lost exports. But the timing, whether for political or economic reasons, was never right to cut the subsidies.

The success of the subsidy cuts so far also seems to have contributed to a continuing reassessment of Mr. Ahmadinejad. He emerged in the diplomatic cables released by WikiLeaks as something of a sober pragmatist — battling with retrograde forces in the government — rather than as the ranting extremist he seemed when he called for Israel to be wiped off the map. In October 2009, according to one of the cables, he argued for a nuclear compromise promoted by the United States that would have sent uranium out of the country for enrichment. And during the protests following the 2009 elections, he is reported to have argued for more freedom of the press — until a general in the Revolutionary Guards slapped him and shouted, "It is you who created this mess!"

The subsidy cuts, which the International Monetary Fund says have amounted to \$4,000 a year for the average Iranian family, began in earnest last month when the rationed price of gasoline jumped to about \$1.44 a gallon from just 38 cents. With a ration of only 16 gallons a month at the subsidized rate, most motorists buy the bulk of their fuel now at the even higher market rate of \$2.64 per gallon, significantly more than the \$1.80 that people pay in nearby Dubai.

In recent weeks, subsidies have also been reduced on flour, water and diesel. But the spike in prices has not provoked the angry protests that followed the introduction of fuel rationing in 2007. The price of bread has tripled, on average, the government says; water, which used to be practically free, now costs between 10 cents and 85 cents per cubic metre, based on a sliding scale under which consumers pay a higher rate the more they use.

The government says these are just the first steps in what it calls an "economic transformation plan" that will also include banking reform, sweeping changes in Iran's tax and customs system, and ever more privatization of state-owned industries. Officials also reported drops in the consumption of gasoline, flour, diesel and electricity, even before the prices were raised.

Iran's state-directed economy has long been plagued by corruption, inflation, inefficiencies and unemployment, which is particularly high among young people. The problems have damaged Iran's ability to compete in world markets. Ending state controls and subsidies have long been seen as the first step in reviving a moribund economy that the C.I.A. estimates grew by an anaemic 1.5 percent in 2009. Analysts say the unemployment and inflation rates are about 20 percent, nearly double the official figures of 11.8 percent and 12.2 percent respectively.

Energy use was the most obvious place to start in reducing subsidies. Iran's population has doubled since the Islamic Revolution in 1979, but energy consumption is five times higher. Few educated Iranians still believe in the old Khomeinist doctrine that Iranians have a right to free energy because of their country's oil wealth.

Until now, however, efforts to increase energy efficiency have been virtually nonexistent. Energy experts say that only 3 percent of buildings nationwide have adequate insulation, and until now it has been common for people to run their central gas heating 24 hours a day with their windows open to allow in fresh air. Official estimates put the cost of energy waste in Iran at \$30 billion a year.

Some of the financial blow to consumers has been softened by cash payments of around \$40 a month, which the government says it is paying to 60 million Iranians. The first two months' payments were deposited in bank accounts in late October, but the money was not available for withdrawal until the middle of last month.

"They made so much fuss about the \$40, they made it seem like \$40, 000," said an unidentified senior economist at a government-run financial institution, who lauded government officials as "social psychologists" who made the public more receptive to the subsidy cuts. "By putting the money in people's accounts but not letting them spend it," he said, "somehow people became eager for the plan to begin."

Transportation costs also jumped 20 percent last month after diesel subsidies were cut. Yet even before the subsidy reforms began costs have increased across many sectors. Scrap steel, for example, is nearly twice as expensive as it was a year ago.

Depending on how well Iran's government can stave off the worst effects of the price shocks, the subsidy reforms could be a political victory for Iran's new right wing — a success for Mr. Ahmadinejad where liberals, now almost entirely excluded from Iran's political scene, had failed.