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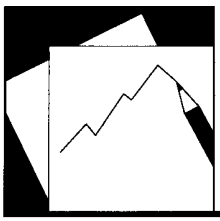

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Iran–The Chronicles of the Subsidy Reform

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Iran—The Chronicles of the Subsidy Reform

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Abstract

On December 18, 2010, Iran increased domestic energy and agricultural prices by up to 20 times, making it the first major oil-exporting country to reduce substantially implicit energy subsidies. This paper reviews the economic and technical issues involved in the planning and early implementation of the reform, including the transfers to households and the public relations campaign that were critical to the success of the reform. It also looks at the reform from a chronological standpoint, in particular in the final phases of the preparation. The paper concludes by an overview of the main challenges for the second phase of the reform.

JEL Classification Numbers: H23, H24, P30, Q40

Keywords: Energy, subsidy, oil dividend.

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I. INTRODUCTION

On Saturday, December 18, 2010, at 9:00 p.m. Tehran time, speaking in a televised "conversation with the nation", President Ahmadinejad announced the start of what he termed the most sweeping economic "surgery" in Iran's modern history. Just after midnight on December 19, Iranian media began releasing announcements detailing the new price structure for liquid fuels. Within twenty-four hours, new natural gas, electricity, and water tariffs were published, and allowable ceilings for the increase in taxi and public transport tariffs followed. At the time, close to 80 percent of Iran's population was granted unrestricted access to compensatory payments that had been deposited in specially-created bank accounts starting in October 2010.

The reform, officially referred to as *Targeted Subsidies Reform*, made Iran the first major energy producing and exporting country to cut drastically massive indirect subsidies to energy products and replace them with across the board energy dividend transfers to the population.[3] It is estimated that the price increases removed close to US$50–US$60 billion dollars in annual product subsidies. By December 2011, in the first 12 months following the price increase, Iranian households will have received at least US$30 billion in freely usable cash, and another $10–$15 billion will have been advanced to enterprises to finance investment in restructuring aimed at reducing energy intensity.

This paper, written during the first few months following the start of the reform, summarizes the preparations for the reform, its implementation, and immediate post-implementation policies and risks. The main objective of the paper is to document the actions taken by the various Iranian policy-makers and administrative bodies during the preparation and implementation of the reform. The paper does not explore Iran's other longer-term economic reforms and policies undertaken over the past several years. The paper does not discuss Iran's overall macroeconomic policies (specifically fiscal, monetary and credit, and exchange rate policies) in the period preceding the time of the implementation of the subsidy reform and in the months following the price adjustment.

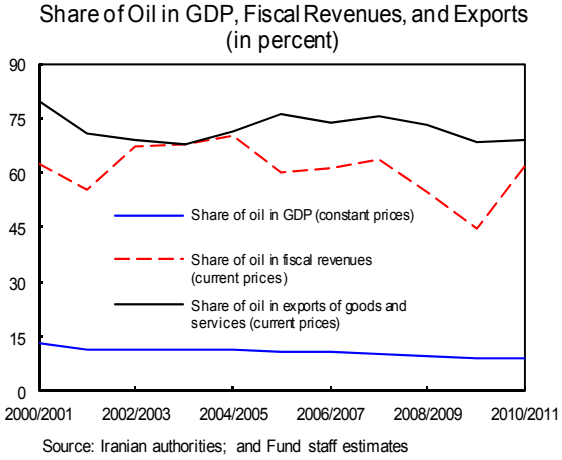
The paper takes a two-dimensional look at the reform. It looks at the specific economic and technical issues involved in planning and implementing the reform. Also, it looks at the reform from a chronological standpoint, in particular in the final phases of the preparations. The paper is organized as follows. It starts with a brief overview of the role of oil in Iran's economy (Chapter II), followed by a discussion of the objectives of the reform and of the microeconomic theory of consumer choice underpinning the reform (Chapter III). Chapter IV

[3] Within days of the start of the Iranian reform Bolivia and Pakistan attempted to raise energy prices to reduce subsidies. Both attempts had to be abandoned in the face of massive public opposition. On January 20, 2011, the *Wall Street Journal* noted that "Iran's handling of the [reform] plan could serve as an example for the region, analysts say." "*Iranians, Given No Choice, Adjust to Soaring Prices*," WSJ, January 20, 2011.

describes the political process and context that led to the approval of landmark *Targeted Subsidies Reform Act* of January 2010. Chapter V discusses the issues considered by the authorities when deciding the broad timing and size of the initial increase of energy prices, and presents an overview of the most critical economic and administrative-technical measures undertaken by the various administrative bodies to prepare for and implement the reform. Chapter VI reviews the successful public relations campaign launched by the authorities in support of the reform. Chapter VII focus on the chronological developments in the weeks just preceding and following the reform day, providing an inside look at the mounting drama and anxiety among Iran's political and administrative bodies, the media, and the society that inevitably preceded the launch of the massive price increases. Chapter VIII concludes by an overview of the main challenges facing Iran's economy as it begins to adjust to the new energy prices and dramatic shift in income distribution and related spending decisions that resulted from the reform.

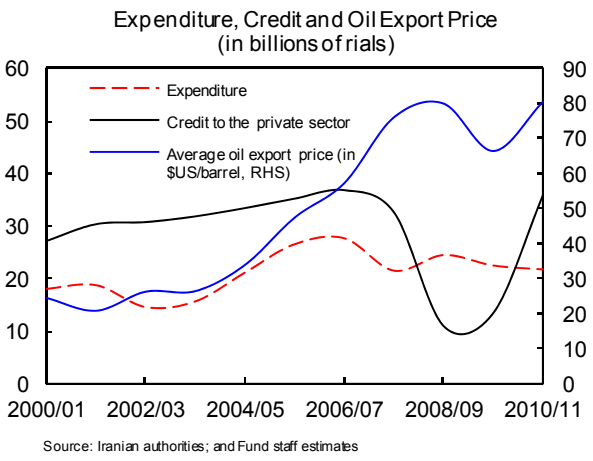
II. The Role of Oil in the Iranian Economy

Although oil and gas production has accounted for an increasingly smaller share of real GDP, oil and gas revenues remain the main source of foreign exchange earnings and fiscal revenues. The share of oil in real GDP fell from an average of 40 percent of real GDP in the 1960s to about 10½ percent in the last decade, reflecting average annual non-oil GDP growth rate of 5.7 percent compared to only 4.4 percent for oil and gas GDP. Oil and gas receipts accounted for about 72 percent of export revenues in the last decade, despite rapid non-oil export growth. Oil and gas revenues also account for 65 percent of fiscal revenues, and are likely to remain the main source of financing for development projects in the foreseeable future notwithstanding recent efforts to diversify fiscal revenues.

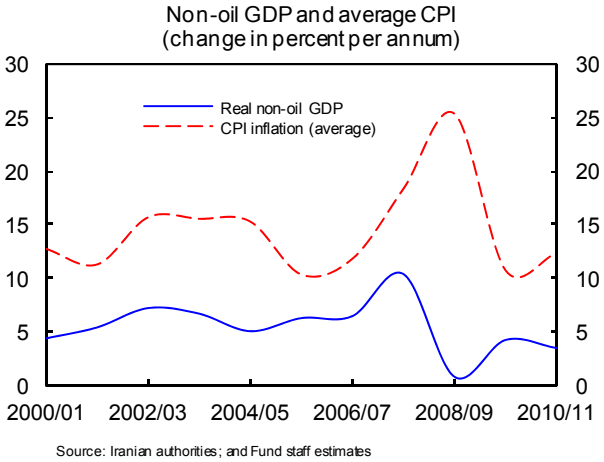


Source: Iranian authorities; and Fund staff estimates

Iran's high dependence on oil export revenues has had a profound impact on its business cycle. In the most recent business cycle during 2002-2008, fiscal spending and credit growth increased at the same time as export revenues and oil prices, resulting in an overheating of the economy and a surge in inflation. The subsequent tighter monetary and fiscal policies coincided with the sharp fall in oil exports caused by the international recession of 2008-2009. As a result, inflation and output declined sharply.

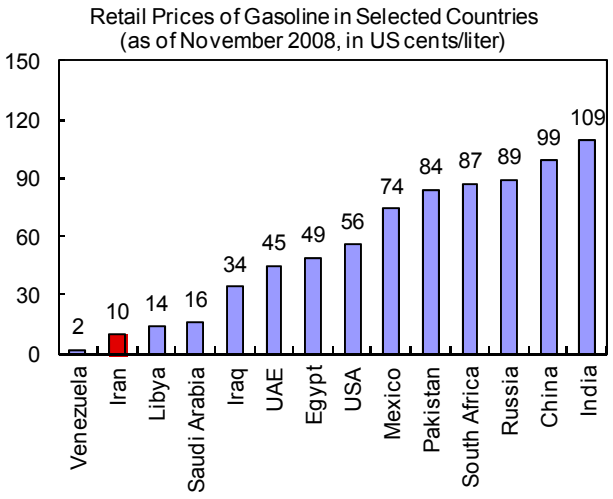


Source: Iranian authorities; and Fund staff estimates

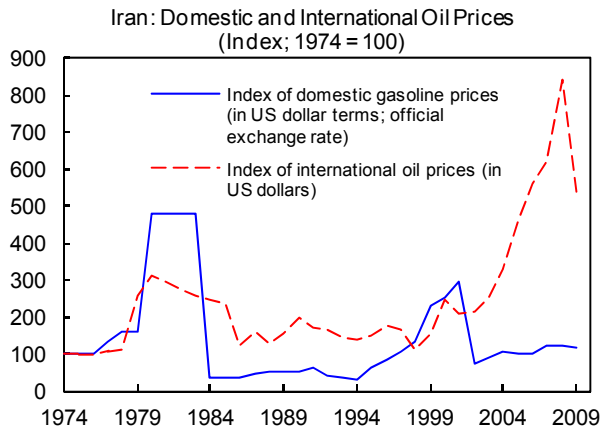


Source: Iranian authorities; and Fund staff estimates

Domestic energy prices have historically been set administratively in Iran, as in the majority of oil exporting countries. They were set at a level high enough to cover production costs and have been changed only occasionally. This worked well when international oil prices were relatively stable and low, and close to production costs. However, when international prices began to rise after 2002, low domestic energy prices became increasingly out of line with the market value of oil. In addition, high domestic rates of inflation and subsequent exchange rate depreciations contributed to further erode domestic energy prices vis-à-vis their international benchmarks. The March 2002 unification of exchange rates and the resulting rial depreciation also accentuated a growing disparity between domestic and international energy prices.



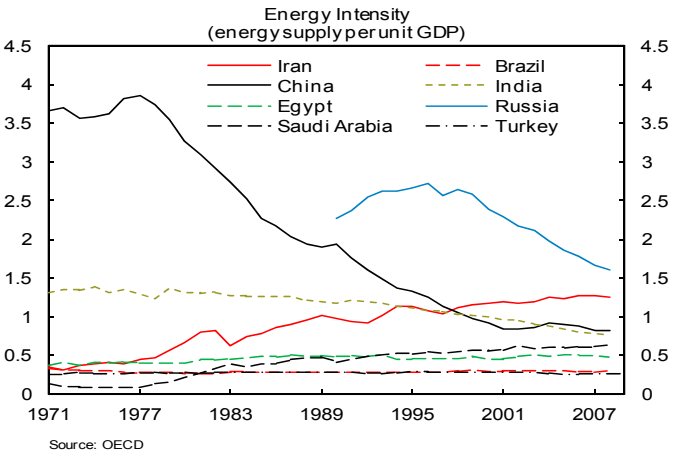
Source: GTZ (www.gtz.de/en/themen/29957.htm)

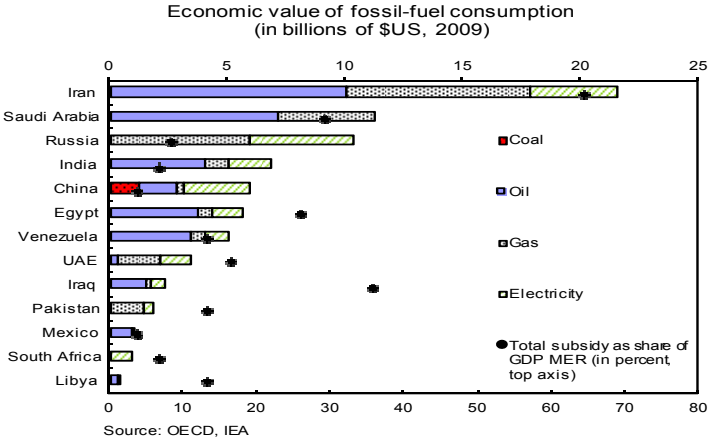


Source: Iranian authorities; and Fund staff estimates

Increasingly cheaper energy stimulated demand, making Iran the country with the highest level of energy subsidy. Not surprisingly, domestic energy use and energy intensity in Iran, as in many other energy producing countries, increased rapidly. Cheap domestic energy prices led to a rapid increase in domestic energy consumption. As a result, Iran became one

of the most energy-intensive economies in the world. The high domestic absorption of crude oil distillates, natural gas, and electricity reduced the availability of these energy products for the export market. Iranian oil energy companies were also increasingly starved of funds needed for investment since domestic energy prices were set at barely cost recovery levels. Environmental pollution and its impact on human health, as well as the time lost due to traffic congestion on Iranian roads provided additional urgency for the reform. Not surprisingly, by 2007 some analysts started questioning not only Iran's plans to increase its oil production capacity, but also its ability to stop a decline in oil production and exports.





III. Objectives of the Price Reform

By 2008, few people could dispute the need to reform Iran's domestic energy prices. As international oil prices approached US$150 per barrel and f.o.b. gasoline prices hovered around $2 per liter, Iran's domestic price of US$0.10 per liter of gasoline was clearly out of touch with reality, unsustainable and unjustifiable by any economic theory. Iran was importing increasing amounts of gasoline to supply domestic demand. Fuel waste and fuel smuggling to neighboring countries were making news headlines.[4]

The Iranian authorities were clear from the outset that the main reform objective was to reduce waste and rationalize consumption. By compensating households for the energy price increases, most consumers would be better off because the higher energy price would discourage some marginal gasoline consumption, while the cash compensation would allow consumers to buy more other goods and services. Box 1 uses a numerical example to discuss

[4] The rationing of gasoline started in June 2007 reduced demand growth and smuggling, and encouraged development of alternative fuel vehicles (CNG). But it was always considered a temporary measure as the price for gasoline purchases in excess of the quota was set at a still relatively low level of US$0.40 per liter.

Box 1. The Consumer Equilibrium Theory

Representative consumers (households) earn Rs 3 million per month. Their utility function is estimated at:

$$U(E, O) = E^{\wedge(1/10)} * O^{\wedge(9/10)},$$

where E represents energy consumed and O is consumption of other goods & services. Initially, energy price is set to: $P_E R$ = Rs 1,000 per unit; and other goods and services price is set to: P_O = Rs 1,000.

Consumers spend their income to maximize utility. A representative consumer maximizes utility

$$U(E, O) = E^{\wedge(1/10)} * O^{\wedge(9/10)}$$

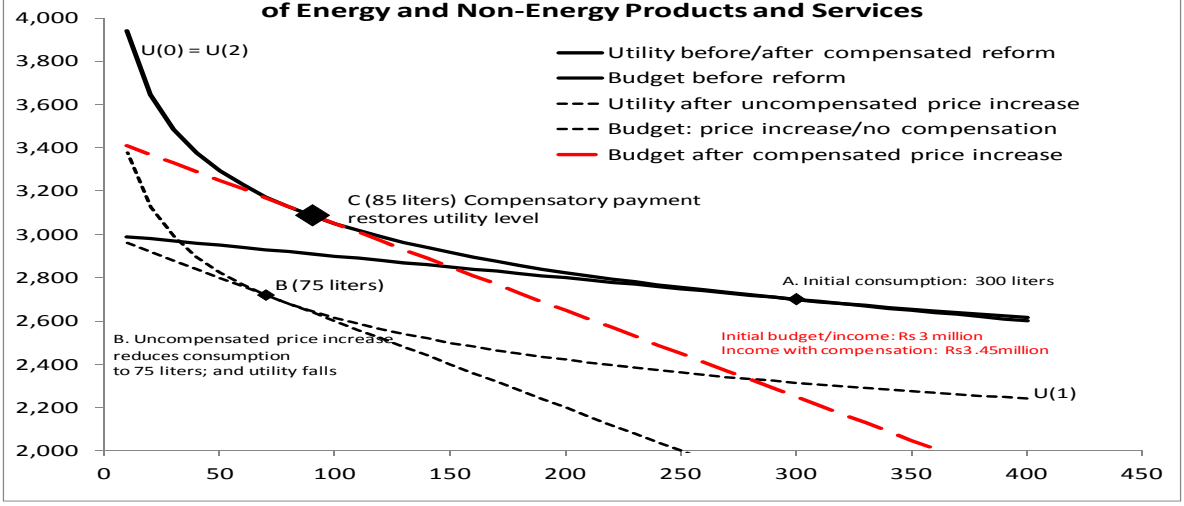
subject to a budget constraint: $P_E * E + P_O * O <= 3{,}000{,}000.$

In this example, consumers maximize utility by purchasing 300 units of energy and 2,700 units of other goods and services. However, since domestic energy prices are well below their opportunity costs, if allowed to do so, most households could increase their welfare by selling some of the energy they currently use at the opportunity cost price and use the proceeds to purchase more units of other goods and services. In practice, however, it is difficult for individuals to export energy to the international market and energy. As a result, energy is wasted as consumers are stuck in a suboptimal equilibrium.

To remedy the problem, the government decides to allow international prices to be passed through to the domestic market. Of course, the price increase is unacceptable to the population unless it is accompanied by adequate compensation. Such compensation allows consumers to offset the loss of utility from reduced energy consumption after energy prices are raised by higher consumption of other goods and services.

In the diagram below, a representative household initially buys 300 units of energy and 2,700 units of other goods and services, and enjoys utility U(0)(Point A). After the price of energy is quadrupled from Rs1,000 to Rs 4,000 per liter, in the absence of any compensation, households' utility plummets as real incomes fall. With the new prices, household choose to buy 75 liters and 2,700 units of other goods and services. Their utility falls to U(1)(Point B). To ensure that households' utility does not fall and that households accept the reform, the government pays out just enough compensation to allow households to increase purchases of both energy and other goods and services to restore their utility to the original level (U(2) = U(0). In the example below, a compensation payment of about Rs 450,000 brings consumers back to the initial utility level U(0)(Point C). In the new equilibrium, consumers purchase about 85 liters of energy and 3,100 units of other goods and services.

Figure 1. Impact of Compensated Price Increase on Consumption of Energy and Non-Energy Products and Services



the consumer optimization problem and the substitution and income effects of a compensated price increases. Understanding how individuals and families allocate their incomes and how a simple compensatory scheme could win a broad-based social support for even massive price increase was critical to the design of the reform.

The reform would also improve social equity in the distribution of Iran's hydrocarbon wealth. For the poor who benefited little for cheap domestic energy price, the compensation would represent a large share of their income, lifting virtually every Iranian out of poverty. This gave the government a powerful public relations and moral argument in support of the reform.

The likely large substitution effect triggered by large price increases could provide a significant stimulus to Iran's domestic production and further diversification efforts, particularly given the slow growth in recent years, and relatively high, double-digit unemployment. The distribution of about $30 billion in annual compensatory payments directly to the population would support domestic demand and nonenergy sector growth.

The reform was not expected to contribute to fiscal consolidation. The reform legislation, and the political debate that preceded it, ruled out using the reduction of energy subsidies to improve the country's fiscal balance. To the contrary, Iranian reforms, including the privatization program launched in 2006, aimed at reducing the size and the role of the public sector in the economy. However, potential large savings in domestic energy use could make significant quantities of crude oil and refined products available for exports (Box 2). The revenue from such exports could support a virtuous cycle of investment in the energy sector that would add production and refining capacity and further increase exports.

IV. Reform Legislation

The parliamentary debate on the *Targeted Subsidy Reform Act* (*Reform Act*) started in late 2008. At the time, the government proposed to launch the subsidies reform at the start of the new Iranian calendar year 1388 (on March 21, 2009). However, mustering the political backing for the reform was difficult in the months preceding the June 2009 presidential elections. In particular, some parliamentarians were concerned that cash transfers to the population could provide significant election advantage for the incumbent president running for re-election. As a result, the parliament failed to agree on the reform at that time.

Work on the reform legislation resumed in earnest in the fall of 2009. Deteriorating economic situation, blamed on the international crisis, new U.N. Security Council and unilateral sanctions against Iran, and weak overall reform progress, added political urgency for completing the reform project. On January 5, 2010, the parliament approved the *Reform*

Act, which was then swiftly approved by the Guardian Council on January 13, 2010, with a likely tacit understanding that the reform will start at the beginning of the new Iranian year

1389 (on March 21, 2010). The reform, planned to be implemented over five years, would coincide with the Fifth Five Year Economic, Social and Cultural Development Plan (Fifth Five Year Plan) for the Iranian Years 1389–1394 (2010–2015).[5] In the first year of its implementation, the reform was to raise only an estimated 200 trillion rials (US$20 billion) in additional revenues for any price increases.

Box 2. Simulating Aggregate Cash Flows from a Hypothetical Gasoline Price Increase

The example below shows the impact of the price reform on aggregate financial flows in the gasoline sector. The quadrupling of the price of gasoline in Iran is estimated to have reduced daily gasoline consumption from about 66 million liters to about 54 million liters. At the same time, gasoline sales are estimated to yield 81 billion rials in additional annual sales, Rs 54.8 billion from the domestic market and Rs 26.3 billion from exports (or savings from reduced imports). As a result, the government can compensate consumers by up to Rs 1.0 million per person per year without incurring losses. This would amount to distributing up to US$90 per family of five for every two-month period to compensate for the increase in gasoline prices if the government were to award the entire revenue windfall to households. In practice, somewhat lower compensation would be warranted and would likely gain social acceptance. Also, the reform allocated some compensation to be paid to other gasoline consumers, the corporate sector and the government.

Gasoline prices, revenues, and possible compensatory payments

	Gasoline market	
	Before the reform	After the reform
Domestic price (rials per liter)	1,000	4,000
Daily use (average; millions of liters) 1/	66	54
Annual use (billions of liters)	24.1	19.7
Total revenue (billions of rials)	24,090	78,840
Increase in revenues (billions of rials)		81,030
From domestic sales		54,750
From incremental increase in exports		26,280
Per person (per year, in thousands of rials)		1,080
Per person (per two-month period, in thousands of rials)		180
Per family of five (per two-month period, in US dollars)		90
Memorandum item:		
Export price for gasoline (in rials)	7,000	7,000
Population (in millions)	75	75
Exchange rate (rials/US$)	10,000	10,000

Sources: CBI, Iranian media; and Fund staff estimates.

1/ As widely reported by Iranian media in late January 2011.

[5] In the end, the drafting of the Fifth Five Year Plan was delayed by one year and the Plan formally applied to the years 1390–1394 (2011/12-2015/16).

The *Reform Act* envisaged the replacement of product subsidies with targeted transfers to the population, with some assistance to Iranian companies and the government. The *Reform Act* stipulated that households would receive at least fifty percent of the increase in revenues derived from the reform. Initially, the benefits were to be paid in cash, while in a second phase, some of the additional revenues were to be used to support higher social benefits and public goods. Thirty percent of the additional revenues were to be used to assist Iranian companies restructure to adjust to the new, dramatically higher energy costs. The remaining twenty percent of the additional revenues would go to the government to cover government's own higher energy bill. Article 15 of the *Reform Act* authorized the government to establish a new Subsidy Targeting Organization to ensure efficient centralized management of the reform.

V. PREPARATION OF THE REFORM

The government made long and careful preparations to ensure the success of the reform and its support by the public. In particular, decisions had to be made about the timing and speed of the price adjustment, the distribution—size and form—of compensatory payments to the population and the corporate sector. Macroeconomic policies prepared the ground for the reform by helping reduce inflation in the period preceding the reform. Ensuring that the banking sector could distribute the compensatory transfers was also a key aspect of the preparation of the reform.

A. Reform Timing Considerations

The approval of the Reform Act by the middle of January 2010 left little time to ensure its implementation on March 21, 2010. A number of key reform implementation details were neither discussed nor included in the *Reform Act*, implying that the reform would have to be delayed. For example, it was not clear who in the population would receive the compensation, how the compensation amount would be calculated, paid, and how frequently it would be distributed.

The authorities also wanted to ensure price stability for most nonenergy essential goods around the time of the reform. To accomplish this objective, time was needed to build-up inventories to ensure their seamless availability in the weeks preceding and following the start of the reform.

Energy distribution companies needed time to prepare new software to handle the proposed multiple tariff structure for many energy products. For example, for the first few months following the start of the reform Iranian gasoline stations would need to handle sales of regular gasoline at three different prices: Rs1,000, Rs 4,000, and Rs 7,000 per liter, depending on whether the buyer used old quota, new quota, or purchased regular gasoline at the free market price.

Finally, the government believed there were merits in timing the reform for the period of the year with the lowest energy use, around November-December: personal travel, and the related gasoline demand, was at its seasonal low, and the agriculture harvest would be completed, thus further reducing the impact of the sharp diesel price increase on the economy.

B. Reducing Inflation

Ensuring low rates of inflation before the start of the reform was a major policy objective in the months leading to the start of the reform. In the year preceding the reform, the Central Bank Governor repeatedly indicated that inflation would fall well into the single digits in the fall of 2010: indeed, inflation fell considerably from close to 30 percent in mid-2008 to 7 percent in early 2010.

The authorities also committed to stabilize the exchange rate to limit inflationary trends and expectations. In September 2010, after some temporary exchange rate volatility, the President called on the Central Bank of Iran to appreciate the rial. The central bank's leadership made frequent public statements in support of the rial, arguing that the country's international reserves remained strong and benefitted from the apparent high share of gold in the CBI's reserve mix. Furthermore, government officials reminded the population that the upward trend in oil prices in 2010 provided sufficient inflows of foreign exchange to justify stable, if not appreciating rial.

Administrative policies were also used to further stabilize prices. In the months leading to the reform, the authorities launched a campaign aimed at preventing producers and retailers from increasing prices in anticipation of the reform. Enterprises found violating the instructions were fined and ordered to reverse the price increase. In addition, the government built stockpiles of domestically produced and imported consumer goods, including many perishable good. The availability of the stockpiles was well advertised in the media to dissuade merchants from increasing prices. The authorities also prepared and discussed in public possible measures to distribute directly many of the basic staples and consumer goods to counter hoarding and panic buying.

Notwithstanding these efforts, the CPI index began to crawl up starting in the summer of 2010. Growing inflationary pressures in the world's commodity markets, reform expectations, and the injection of credit by the CBI to support a relatively large housing construction program all contributed to an uptick in inflation.[6] On January 3, 2011, the CBI reported the December 2010 CPI surged by 1.5 percent (not seasonally adjusted) compared to its November reading. For the twelve month ending December 20, 2010 the end of period CPI was up by 12.8 percent.

[6] The injection of central bank credit for housing construction may have also caused short-lived volatility in Iran's domestic foreign exchange market in September 2010.

C. Magnitude of the Price Adjustment

The *Reform Act* only stipulated the net gain (200 trillion rials) in revenues from the price increase in the first year of the reform, but not the size of the price increase. The government believed that the price increase had to be meaningful to be able to effectively reduce energy demand. It argued that price increases of 200–500 percent would not much impact on demand, while still causing some economic hardship, and possibly leading to a build-up of opposition to future adjustments. Moreover, relatively small domestic price increases could be rapidly eroded in real term by domestic inflation, an increase in international prices, or exchange rate depreciation.

Significantly frontloading the price increases would have the additional benefit of increasing the nominal amount of compensatory payments made to households. Large compensation would make the reform easier to sell to the poorest households, who would see a big increase in their income, while being relatively little affected by higher energy prices, having usually no car and few energy appliances.[7] A large price increase would of course not be much welcome by the richer households, but they were unlikely to garner much political support for opposing the reform. The more affluent, better educated and entrepreneurial socio-economic groups may also have been more aware of the staggering economic, health, and social costs of energy waste, and have realized the large long-term benefits that they could reap from the reform.

The government therefore initially requested to amend the *Reform Act* to frontload the price increase, but this was met with cold reception in parliament. As an alternative, the government decided to use the flexibility included in the *Reform Act*, which only stipulated the net gain in revenues from the price increase in the first year of the reform, but not the magnitude of the price increase, or the exact timing of the reform. By delaying the reform, the government felt that it could increase the price adjustment. For instance, to meet the annual revenue target, the government could raise prices by three times as much by starting the reform in the eight month of the year.

D. Energy Distribution and Pricing

The *Reform Act* stipulated that prices should be adjusted to 90 percent of their f.o.b. Persian Gulf levels within five years, but did not specify the price adjustment path for the different products. In the early phase of reform planning, more than 200 price scenarios were simulated to reconcile the following objectives: the price increases had to be sufficient to reduce excessive demand; they also had to discourage inefficient substitution between

[7] In the days preceding the reform the government emphasized that for many of the Iran's poor the $40 monthly per person ($200 per family of five) benefit added significant income supplement. For many rural families the benefit amounted to over 50 percent of their labor income.

compressed natural gas and liquid fuels; and, they had to take into account the lack of availability in some region of natural gas for home heating, the largest single energy-related expense for most low-income household. In the end, the authorities opted to implement a multi-tier pricing system to smooth the reform's impact and encourage rational energy use.

The use of the multi-tier tariffs on electricity, natural gas, and water played an important role in moderating the impact of the price increases on small users, mostly the poor and accounting for regional disparities in availability of different heating fuels. Unit tariffs on electricity, natural gas, and water use were set using escalating schedules. The cost of the first 100 kWh of electricity use was set at a low price of just Rs 270 (about US$0.027) with some users in hot climate eligible to regional discounts. However, unit prices were set to rise rapidly, all the way to Rs 2,100 for use in excess of 600 kWh. Large household consumers were charged prices marginal higher than in international markets. The tariff schedules were further differentiated by region. Prices were set at lower rates in hot regions with relatively higher air-conditioning demand. Tariff schedule for natural gas and water were similarly differentiated by quantity used and region. In areas where natural gas was not available, heating costs were to remain closely monitored and regulated, and lower priced (at Rs 1,000 per liter) rationed kerosene and lower electricity rates would be provided to ensure affordability of heating.

The use of the electronic cards system for gasoline rationing and quotas introduced in June 2007 also provided a de facto multi-tier energy pricing structure for gasoline, making the reform seem gradual, while accomplishing the main objective of sharply increasing "free market" prices. The price of rationed gasoline would be increased but remained well below the full price at which they could purchase unlimited amount of fuel. In addition, households were told that they would not lose any of their previous unused gasoline quotas. Rationing also required the implementation of a comprehensive vehicle registration system and personalized distribution and management of the gasoline quotas.

E. Household Transfers

Who gets what? The allocation of the cash transfers

The *Reform Act* stipulated that households were to receive 50 percent of the revenues raised in the reform, but did not indicate who should receive the compensation. Initially, the authorities leaned towards targeting the transfers towards the poorer segments of the society. To support such targeted transfers starting in April 2010 the Statistical Center of Iran began collecting information on the economic situation of individual households.[8] Officials mentioned the bottom 30 to 50 percentile of the income group, and then the lower

[8] At present, household registration is based on self-assessment. The information held by the Statistical Center of Iran will be upgraded several times a year.

70 percentiles as likely beneficiaries. As time passed, however, it became clear that it would be administratively difficult to identify and properly screen the recipients. Also, denying support for the upper income groups risked triggering public discontent among the group of biggest energy users. In the end, everyone was allowed to apply for the compensatory transfers, which were made equal for all applicants. At the same time, the richest households were encouraged to refrain from applying.

The identification of beneficiaries

The application process for compensation was simple and the rules set were quite forgiving. Iranians only needed to file an application to receive the compensation. There was no means testing and no income verification. The Iranian media repeatedly quoted government officials emphasizing that everyone was eligible to receive compensation and that the government was quite lenient in handling small filing errors. Officials reported an exceptionally high approval rate for all applicants of 98 percent. In the end, on the eve of the price increase, over 61 million individuals (80 percent of Iran's total population of about 75 million) received compensatory payments. Moreover, the authorities made it clear that those who had not filed applications were still eligible to do so, and would receive compensation retroactively. The Iranian media periodically published "Questions and Answers" sections dealing with various issues related to the reform, among other explaining how to update the names of the compensation beneficiaries. Not surprisingly, by May 2011 over seventy million Iranians registered to receive compensatory payments.[9]

The physical distribution of the cash transfers

The physical distribution of cash transfers was well planned, and spanned over four weeks, preceding the price increase by well over one month. It was also well publicized. Starting on October 19th the government began depositing money in household accounts. On that day the Iranian media announced that newly established "targeted subsidies" accounts for households in Khorasan Shomali, Khorasan Razavi and Khorasan Jonubi provinces were credited with "targeted subsidies." Specifically, each account was credit with an amount equal to 800,000 rials multiplied by up to six household members. The process of crediting the accounts of the 21 million beneficiaries (about 19 million accounts) living in 31 administrative provinces of Iran continued until November 11, when accounts of residents of Tehran, Semnan, and Alborz provinces were credited. At the same time, the authorities clearly announced that access to the deposits would be frozen until the day when energy prices were increased.

[9] Iranians residing outside Iran were not eligible to receive "targeted subsidies," though they could possibly become eligible upon return to Iran. In May 2011, media reported that an estimated two million Iranians residing outside Iran may have applied for compensation and some may have been receiving them.

To ensure publicity of the process, the Iranian mass media reported daily on the progress made in distributing the compensatory deposits. Every day, an announcement would be made informing that "targeted subsidies to households in [names of two provinces] would be made by midnight of the day. So far, household in [the list of provinces where household accounts had already been credited with deposits] have received their targeted subsidies." To ensure that all applicants had received their "targeted subsidies", the authorities set up a special website (www.refahi.ir) to allow anyone to verify whether they had received the funds, and telephone hotlines for questions about the reform.[10]

F. The Corporate Sector

Equally to critical to the success of the reform was its acceptance by the corporate sector. In the months preceding the reform, the authorities at various levels up to the president met very frequently with all sectors of the economy to listen to their questions and concerns and understand better the potential impact of the reform on their business. At the same time, the authorities conducted a systematic analysis of more than 12,000 enterprises along several criteria to assess the various channels through which the reform could affect them. Out of these enterprises, 7,000 were selected to receive some form of targeted assistance. This included direct assistance to enterprises as well as sales of limited quantities of fuels at somewhat discounted rates to moderate the impact of the price increase on the input costs of enterprises in the industrial and agricultural sectors. For example, although the full free market diesel price was raised from Rs 165 per liter to Rs 3,500 per liter, selected sectors of the economy, such as agriculture, fisheries, and transport, would be offered some diesel at Rs 1,500 per liter.

Direct assistance to enterprises was to be financed by 30 percent of the additional revenue from the price increases envisaged under the *Reform Act*, and included various support packages, including interest subsidies on loans for the adoption of new, energy-saving, technologies, credit lines to mitigate the impact of higher energy costs on cash-flow, and credit lines to spread the costs of higher energy costs over a three-year period. In addition, specific industries have benefited from reduced fees and taxes and special export awards. To protect and support demand for domestic industries, tariffs on selected imports were introduced or increased.

At the same time, the authorities recognized that the adoption of new technologies would not be sufficient to reap the full benefits of the subsidy reform in terms of efficiency gains. Reducing waste and improving the production process would also contribute to reduce

[10] Only households that had received approval and pursuit code from the site of Statistical Center of Iran could enter the subsidy reform site and give their account number.

energy intensity by increasing the amount of output per unit of energy consumed. Several initiatives were introduced to improve enterprises' efficiency, such credit for the hiring of consultants to improve management.

G. The Banking Sector

Iranian Banks played a critical role in the distribution of targeted subsidies to households. Using bank accounts, as opposed to dispensing cash through a network of regional and local governments, offered several advantages: first, it was efficient and eliminated the risky task of carrying and distributing large amounts of cash around the country; second, it allowed the government to let all the recipients see the transfers received well in advance of the actual price increase. This consideration was very important in gaining the public's buy-in for the reform, and making it virtually irreversible, as many Iranian households would eagerly await the price increases that would give them access to the deposits; and third, the authorities expected that a significant amount of the credited funds would be saved by the population with the banks, which would make liquidity management easier.

Preparing banks for the reform involved a number of steps. First, an estimated 16 million new accounts had to be opened to ensure every eligible family could receive benefits. Second, banking infrastructure and the payment system had to be upgraded to guarantee seamless, possibly simultaneous access to the accounts by a large number of the beneficiaries. In the hours preceding the price reform, the authorities made it repeatedly clear that Iran's ATM network was ready to withstand a possible onslaught of the population rushing to withdraw their targeted subsidies. Finally, the ATM network had to be expanded to the farthest corners of the country to allow Iran's rural population access to the accounts.

Banks were also to play a critical role in the allocation of subsidies to enterprises, as the latter was given in part by reducing the interest rate on loans made for investment in energy-saving technologies, and banks receiving the interest rate differential from the government.

H. The Government Sector

As in the case of the corporate sector, the authorities foresaw the need to assist Iran's public sector institutions in dealing with the consequences of the sharp increase in energy prices by allocating additional revenue from the price increase to pay for the higher energy bill faced by the government sector. In particular, significant resources were allocated to provincial and local governments. However, it is not clear whether the allocation schemes provided the needed incentives to promote energy savings by government-funded organizations.

VI. THE PUBLIC RELATIONS CAMPAIGN TO SELL THE REFORM

The reform was preceded by an extensive public relations campaign to educate the population on the growing costs of low energy prices, and on the benefits expected from the reform. The government appointed a special spokesman to coordinate the envisaged extensive public relations campaign in support of the reform. Iranian news media (newspapers, websites, radio and television), public seminars and meetings carried a broad range of educational programs showing the energy waste due to low energy prices. Political, business, and social leaders, as well as academics were mobilized to speak in favor of the reform and enumerate the benefits expected from the reform. The President and senior government officials frequently spoke about the inefficiencies resulting from cheap energy.

The authorities emphasized the social inequity resulting from cheap energy. Historically, in most countries, the elimination of subsidies to staple products results in loss of real income that disproportionately affects poorer households. For this reason, the Iranian authorities emphasized from the outset that the reforms were not about eliminating subsidies, but switching subsidies from products to households. The reform would therefore benefit poor households, who would receive cash benefits, while in the past they were not benefitting much from cheap energy that was mostly consumed by the richer groups.

Households were exposed to new prices well before the price increases. Iranian households received electricity bills that showed the true unit cost of electricity and the full amount due at the true cost in addition to the ongoing low rates and amounts due. Similarly, "free market" priced gasoline was available since June 2007. While, at first, households received very generous quotas of cheap gasoline—120 liters per car and per month, with supplementary allocations available for summer vacation travel—, the quotas were gradually reduced to 60 liters per month and per car in 2010, stimulating the demand for fuel at higher, "free market" prices. These measures made the reform effectively more gradual.

The extensive publicity in the media of crediting of the "targeted subsidies" to accounts of 62 million beneficiaries played an important role in supporting the reform. Publicizing the distribution of compensatory deposits made the start of reform effectively irreversible: close to 80 percent of Iran's population was told that within few weeks they would be eligible to receive what for many would be a significant sum of money.

The authorities did also not shy away from using the "show of force" to demonstrate their determination to ensuring social stability. In the months preceding the December 18 price increases, Iranian media reported senior government officials' warnings against protests. At the same time, the frequency of such warnings abated as the reform day approached, perhaps reflecting the authorities' conviction that the reform was becoming popular. In a number of instances, senior police officers would start their media interviews by stressing the need for vigilance, but claiming in the end that, in practice, they did not expect much opposition to the

reform. Even the government's more ardent opponents neither questioned the need for the reform nor its main elements, but argued that the government lacked the skills necessary to implement the reform.

In the weeks directly preceding the reform the media blanketed Iran with statements supporting the reform. Friday prayers across Iran included discussions of the need for, and benefits of the reform. Provincial leaders held routine conversations about the reform. Starting in late November, one by one, central and local government, the Ministry of Commerce, fuel management units, and the banking sector reported their readiness to implement the reform.

Some elements of the communications strategy during the distribution of the compensatory deposits could, however, have been better managed. For instance, the lack of clarity of early reports on the purpose of deposits in the "targeted subsidies" account or about the calculation method, created some temporary social tension and uncertainty. For a few days Iranians were left wondering for how long the deposits were expected to last and how many families were eligible to receive them.[11] Only few days later, the President explained in a televised address that the deposits were "per person and for two months", and would be made every two months, two months in advance. He also added that another 800 thousand rials per person would be deposited in calendar year 1389.

The President's explanation created some uncertainty on the date of the reform, as it implied that the authorities were preparing to raise prices in late November, most likely around November 21. This would leave four months until the end of the year, which would explain the plan for a second tranche of the targeted subsidies credits in that year. On November 20, the MehrNews news agency also published an editorial that noted the overall readiness of Iranian institutions to carry out the reform. The editorial went as far as discussing how senior government officials were to meet with the President late in the evening to receive the green light to launch the reform. The editorial ended by literally calling on the President to launch the reform immediately.

While overall the public relation campaign in preparation of the reform proved successful, a few missteps created some unnecessary confusion and social tension. Publicizing upfront all the details about the value and conditional periodicity of the "targeted subsidy" payments would have calmed the situation.

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[11] There were reports that only up to five family members were eligible for the compensation. The government denied them but later it turned out that larger families did not receive the expected compensation. The government had to make supplementary deposits to large families in early December. In addition, the initial distribution of compensatory payments did not include compensation for the planned bread increase. These were carried out in late December, within days after the announcement of the start of the reform on December 18.

VII. Implementation of the Reform

A. Selecting the Day and Hour of the Reform

In contrast to the relatively uncoordinated implementation of the gasoline rationing scheme in June 2007, the decision about the exact timing of the implementation of the reform was delegated to the president from the beginning. At the time of the introduction of the gasoline rationing scheme, a number of officials made contradictory public statements about the timing and size of the fuel rationing, which contributed to social tension and limited riots at some gasoline stations. To avoid these problems, all public officials repeatedly stated throughout 2010 that the decision on the timing of the reform would be announced by the President in a televised speech, and would precede the price increases by only an hour or two. Iranian newspapers speculated that only four people in Iran—the President, the Vice President, the Minister of Economy and Finance, and the Deputy Minister of Economy and Finance in Charge of the Reform—were involved in planning the reform date, and that only the President was responsible for deciding on the exact timing of the implementation.

As the reform day approached, government officials made it clear that no Iranian would lose any of the unused gasoline remaining on their rationing cards, which gave the government a lot of flexibility in deciding the day of the reform. Hours before the President announced the price increase Iranians were allocated another monthly quota of gasoline at Rs 1,000 per liter for December 21, 2010-January 20, 2011. The availability of rationed gasoline at Rs 1,000 per liter one month late on household electronic cards effectively delayed and moderated the price increase for many smaller gasoline users.

B. December 13–21: The Week that Changed Iran

On December 13, Iranian media announced that the President would speak to the nation on Saturday December 18, starting at 9 p.m.. The announcement indicated the President would cover a number of issues, including international relations and the subsidy reform. Although the announcement indicated that the President may announce the price increase, the authorities clearly intended to leave the door open to allow the President to change his mind at the last moment. The authorities were also concerned that some elements of the reform may need more time to be ironed out, such as the readiness of the banking system to deal with a possible massive cash withdrawal from the targeted subsidies accounts, and the capacity of the fuel management system to handle efficiently the multiple fuel price system. Already in November, the authorities had had to delay the start of the reform to fix the fuel system management, ensure the distribution of compensation to families with more than six members, and provide additional time to allow residents to verify and correct possible errors.

On December 17 and 18, Iranian media carried reports of various agencies reporting their full readiness to implement the reform. In particular, Iran's fuel management authority indicated its readiness to adjust prices in all gasoline stations. The authorities also reported that by midnight December 17, Iranians would receive another allocation of the monthly fuel ration

credited to their gasoline rationing cards. The Ministry of Commerce reported its readiness to step in and intervene in the market for many staple products in the event of a rush on products. On Friday December 17, prayers across Iran and television programs also made significant references to the reform and its benefits.

The most important meetings, however, may have taken place in the CBI in the night of December 17 to December 18. The CBI reported the following day that it had met with commercial banks to discuss the implementation of the reform, and had pledged to provide all the necessary liquidity to support banks, and would closely monitor the payment system. Commercial banks declared their readiness to satisfy every request for cash withdrawal from branches and ATMs. At the same time, the CBI leadership appealed to the population not to rush to withdraw their deposits. They also recommended that people transfer funds received into "targeted subsidies" accounts to higher yielding time and savings accounts to safeguard against inflation.

As announced, on December 18 at 9 p.m., the President went on television to discuss a number of current issues. He spoke about Iran's international relations before moving to the topic of the reform. As in earlier speeches, he started by making numerous references to the appalling waste, economic and social costs, and social injustice resulting from cheap energy. He then made a formal announcement that the reform would start the following day, December 19. He also announced that bread prices would be increased within days, but only after all households received a supplementary "targeted subsidy" of approximately four dollars per person per month payable for two months in advance.

Just after midnight on December 19, the Iranian media published announcements detailing the reform. In the following few days, the media issued detailed schedules for electricity, natural gas, and water prices. On December 28, the media announced that all households received the supplementary Rials 80,000 (US$8) compensation related to increase in bread price.

C. The Days Following the Start of the Reform

To prevent public panic, government officials pledged to intervene in the market if necessary by drawing down the large stockpile of inventories of key consumer staples.[12] Price controls were also imposed on most products in the immediate days following the start of the reform, and Iranian companies were pressured to reduce some consumer and industrial goods prices. For example, prices for a number of petrochemical products used for packaging were reduced to partly offset the increase in production costs resulting from the energy price increase.

[12] Fourteen days after the start of the reform the Ministry of Commerce reported that no market interventions had been needed.

Similarly, Iran's two largest car makers, Iran Khodro and Saipa, announced they were either freezing or reducing many prices. Manufacturers of household appliances were also encouraged to offer discounts and favorable terms on installment sales.

Senior government officials were visible and accessible to the media. Almost every minister, deputy ministers, and senior central bank officials discussed progress of the reform. Statements were typically followed by questions and answers session, all widely reported in the media.

Frequent reports on the banking sector indicated very few glitches in the operation of ATMs and the payment system. Only 0.5 percent of funds in the "targeted subsidies" accounts were withdrawn from banks on the first day of the reform. Officials called on the population to transfer their "targeted subsidy" benefits to higher yielding time and savings accounts to shield them from the expected jump in inflation. The central bank also prohibited commercial banks from using "targeted subsidies" funds to recover overdue loans.

The authorities addressed many immediate problems with pragmatism. Some energy prices were reduced and additional quotas or grants at low prices were allocated to the most vulnerable groups. For example, in the immediate days following the price increase, Iranian truckers' profits were squeezed as retail price controls froze their revenues while fuel costs had increased. The government responded by allowing limited price increases and allocating to them a larger diesel ration at low-price. This pragmatic approach in dealing with the hardships caused by the reform ensured social stability.

VIII. Challenges Ahead: Macroeconomic Stability and Corporate Restructuring

The successful implementation of the drastic price increases has created a unique opportunity for Iran to reform its economy and accelerate economic growth and development. The authorities are now faced with the challenging task of translating this opportunity into reality. Pre-reform preparations, for good reasons, centered on ensuring social support for the price increases. Without broad public support, the government would not have been able to increase the domestic prices of energy and other products. However, to ensure the long-term success of the reform, as measured by tangible improvements in economic efficiency and productivity, Iran's corporate sector must adjust to the much higher energy prices and reduce its energy intensity. This will require changing the economy's product mix and production technologies. Iranian companies will need to produce more energy efficient products and produce them more energy efficient technologies.

The main immediate challenge facing the authorities is, however, to allow a progressive pass-through of higher energy prices by eliminating administrative price controls and reducing excessive and arbitrarily set import or export tariffs, while controlling inflation

by coordinated and tight credit, fiscal, and exchange rate policies. Maintaining macroeconomic stability is essential to avoid a rapid erosion of the benefits of the reform. At the same time, new product prices should reflect the adjustment in product mix from Iranian companies and changes in consumer demand away from products and services requiring a lot of energy towards more energy-efficient goods and services.

Reforming Iranian companies will not be an easy task. The experience of other countries that pursued similar reforms shows that corporate restructuring can be a very tricky process. Safeguarding the reforms often involves short-term compromises. At the same time, pragmatism in dealing with narrow, well-defined economic stress should not lead to reform drift and reversals. International evidence of economic reforms is littered with examples of seemingly small-scale compromises that hijacked the entire reforms by resulting in an accumulation of small or larger bailouts that eventually led to very high inflation.

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http://www.irantracker.org/ US based, managed by the American Enterprise Institute (AEI) website. Carries daily review of Iranian press, mostly highlights of political developments, with only marginal interest in economic policy; provides links to full Farsi text of the headline news.

APPENDIX I. SUBSIDY REFORM LAW[13]

Article 1. The government is required to reform the prices of energy carriers in accordance with the provisions of this law:[14, 15, 16]

- Domestic sale prices of energy carriers: gasoline, diesel fuel, fuel oil, kerosene, liquefied petroleum gas (LPG), and other oil condensates, inclusive of relevant costs (including transport and distribution expenses, taxes, and other legal duties) and depending on the quality of carriers, will be adjusted gradually until the end of the 5th Five-Year Development Plan (FYDP) 2010-15, up to a level which shall not be less than 90 percent of Persian Gulf FOB prices.[17]

- Average domestic sale price of natural gas will be adjusted gradually until the end of the 5th FYDP up to a level which shall not be less than 75 percent of average export price of natural gas, excluding transfer costs, taxes and legal duties.[18]

- Average domestic sale price of electricity will be adjusted gradually until the end of the 5th FYDP up to a level which shall be equal to full cost price.[19]

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[13] http://www.icana.ir/News/Parliament/2010/1/52183/0/Default.aspx.

[14] With regard to electricity and natural gas prices, the government is authorized to apply preferential prices, considering geographical regions, type, amount, and time of consumption. In cases where several families or subscribers share the benefits of a single subscription, Water, Electricity, and Gas Companies are required to install additional individual meters for additional families by charging only the cost of meter and its installation expenses; and in case it shall not be possible to install additional individual meters, the number of subscribers shall be increased to the number of individual users of the shared subscription.

[15] Calculation of prices of energy carriers after the first year of implementation of this law will be based on the exchange rate used in the relevant annual budget.

[16] The adjustment of relevant prices in the first year of implementation of this law will be made in a manner that generate an additional aggregate amount of revenue up to RLS 200,000 billion, but not less than RLS 100,000 billion.

[17] Sale prices of crude oil and gas liquids to domestic refineries will be equal to 95 percent of Persian Gulf FOB prices, and purchase prices of products from the refineries will be set in line with the said prices.

[18] To encourage investment, for a period of at least 10 years from the date of approval of this law, the prices of feedstock for industrial, refinery, and petrochemical plants per cubic meter, will not exceed a level which is equal to 65 percent of a basket of gas export prices of Persian Gulf origin (excluding transfer costs).

[19] Calculation of electricity cost price will be based on total costs of energy conversion, transmission and distribution, and fuel costs, with an efficiency of at least 38 percent of power plants and observance of standards; and the efficiency of the country's power plants shall be improved by at least 1 percent per year, so that it reach a level of 45 percent within 5 years from the date of implementation of this law, and also 2 the transmission and distribution power grid losses to be reduced to 14 percent by the end of the 5th FYDP. The government is required to make arrangements for rating of electricity producers in terms of efficiency and its distributers in terms of energy losses by establishing a work group comprising governmental and nongovernmental experts, and to adopt appropriate incentives and supportive policies.

Article 2. To manage the impact of energy carriers price fluctuations on the domestic economy, the government is authorized to keep the prices unchanged for consumers as long as Persian Gulf FOB prices fluctuate within a range of 25 percent, by paying subsidy or collecting differentials, as the case may be, and include such amounts in the account established for regulating energy carriers market, in the relevant annual budget. If price fluctuations exceed the said 25 percent range, prices will be adjusted accordingly.

Article 3. The government is authorized to adjust the price of water and the fee chargeable for sewage collection and disposal, in accordance with the provisions of this law.

- Average price of water for different uses will be adjusted gradually until the end of the 5th FYDP, up to a level which shall be equal to the cost price, considering the quality and the manner of purification.[20, 21]

- Calculation of chargeable fee for sewage collection and disposal services will be based on total costs of maintenance and operation of the sewage system, after deduction of the intrinsic value of delivered wastewater and government aids under the annual budget (in connection with incentive policies).

Article 4. The government is required to make arrangements for gradual targeting of subsidies payable on wheat, rice, cooking oil, milk, sugar, postal services, and air and rail (passenger) transportation services, until the end of the 5th FYDP.[22]

Article 5. The government is required to make available the flour and bread subsidies to consumers, who have applied, to the extent payable in accordance with the annual budget bill, through appropriate methods.[23]

Article 6. The government is required to adopt incentive and supportive policies, which are necessary to establish and expand industrial bread production units, and also to help compensate the losses to the flour and bread production units that may face difficulties as a result of implementing this law. The implementing regulations of this Article will be prepared by the Ministry of Commerce, in cooperation with relevant organizations, and approved by the Cabinet within three months after the approval of this law.

Article 7. The government is authorized to spend up to 50 percent of net proceeds resulting from the implementation of this law under the following items:

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[20] The government is required to set the cost price of water by including all costs of water supply, transfer and distribution, and observing efficiency.

[21] Setting preferential and multiple prices for different uses of water, in view of geographical regions, type, and amount of consumption, will be authorized.

[22] Subsidies paid to producers in agriculture sector in each year should not be less than the same for the preceding year.

[23] Per capita bread subsidy payable to population of villages and the cities with less than twenty thousand people, and vulnerable groups in other cities, will be at least 50 percent more than the average per capita subsidy, at the discretion of the government.

- Cash and non-cash subsidies payable to all households countrywide, considering the level of household income;

- Implementing a comprehensive social security system for the targeted population, such as: (i) Providing and expanding social insurances, health care services, ensuring and enhancing public health, and medical coverage for special and difficult-to-cure diseases; (ii) Providing assistance for financing housing costs, enhancing resistance of buildings, and creating employment; (iii) Empowering and implementing social support programs.[24, 25]

Article 8. The government is required to spend 30 percent of the net proceeds resulting from the implementation of this law to pay for grants, or subsidies on bank facility charges, or specially-managed funds for implementation of the following items:[26]

- Optimizing energy consumption in production, services, and residential units, and encouraging energy savings and observing the consumption pattern introduced by the relevant implementing organization.

- Reforming technological structures of production plants, aimed at increasing efficiency of energy and water, and developing electricity generation from renewable resources.

- Compensating part of losses to the companies providing utility services–water and sewage, electricity, and natural gas—and oil products, and municipalities and townships, incurred as a result of implementing this law.

- Developing and improving public transportation, under the framework of Public Transportation Development and Fuel Consumption Management Law, and paying an amount up to the credit ceiling determined under Article (9) of the said law.

- Supporting the producers in agriculture and manufacturing sectors.

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[24] The implementing regulations of this Article, including how to identify the targeted population, and establish and update the needed databases; the method of payment to the targeted population; and the payments under this Article, will be proposed by Ministers of Economic Affairs and Finance, and Welfare and Social Security, and Head of Management and Planning Organization (MPO), and approved by the Cabinet, within three months after the approval of this law.

[25] The government can open the subsidy targeting account in the name of the head of each eligible family, or another eligible person determined by the government. The government is authorized to exercise control over the manner in which the funds are spent under the said account, including the applicable time, type of drawings, and the refund of amounts that have erroneously been deposited.

[26] The implementing regulations of this Article, including the method of supporting industries, agriculture, and services, and the manner of payments under this Article, will be proposed by Ministers of Economic Affairs and Finance, Industries and Mines, Agricultural Jihad, Commerce, Petroleum, Energy, and Interior, Chairman of the Iranian Chamber of Commerce, Industries and Mines, the Secretary General of the Chamber of Cooperatives, and Head of MPO, and approved by the Cabinet within three months after the approval of this law.

- Supporting production of industrial bread.
- Supporting non-oil export promotion.
- Developing interactive electronic services to eliminate or reduce need for unnecessary traffic.

Article 9. Sources discussed under Articles (7) and (8) of this law, including aid, facilities, and specially-managed funds, will be made available to the said persons through state-owned and private bank and non-bank financial institutions.

Article 10. Receipt of aids and subsidies discussed under Articles (7) and (8) of this law will be subject to providing accurate information. If the provided information proves to be inaccurate, the government is required to take necessary legal actions for refunding the amounts so paid, while preventing future payments. If the persons consider that they are eligible for receipt of the aids and subsidies discussed under Articles (7) and (8) of this law, they may submit their objection to the Commission that shall be foreseen under the implementing regulations of this Article The implementing regulations of this Article will be proposed by Ministers of Justice, Economic Affairs and Finance, Welfare and Social Security, and Head of MPO, and approved by the Cabinet within three months after the notification of this law.

Article 11. The government is authorized to spend up to 20 percent of the net proceeds resulting from the implementation of this law, to compensate its impact on spending and the acquisition of capital assets.

Article 12. The government is required to deposit all income sources resulting from implementation of this law into a special account titled subsidy targeting account with the General Treasury. 100 percent of funds so deposited will be allocated for the uses authorized under Articles (7), (8) and (11) of this law, and under the framework of annual budget laws.[27, 28, 29]

Article 13. The petty cash needed to implement this law will be included in the petty cash of the annual budget, and will be settled from sources generated by implementation of this law during the year.

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[27] The government is required to present credits amounts of sources and uses discussed under the said Articles in four separate items in the relevant annual budget bill.

[28] Cash and noncash aids provided to natural and legal persons as a result of implementation of this law will be exempt from income tax under the Direct Taxes Law 6 approved in Esfand 1366 (February 1988) as amended. Such aids to such persons for compensation in part or in whole of the price of goods or services provided by them will not be subject to the tax exemption provided under this note.

[29] The government is required to provide the Supreme Audit Court and Parliament with the detailed report of operations under this Article every six month.

Article 14. The interchangeability of credits discussed in Articles (7), (8) and (11) of this law will be authorized only for a maximum of 10 percentage point in the annual budget, so that the total proceeds so resulted shall be used as provided in this law.

Article 15. The Government is authorized to establish, within one month after coming into force of this law, a new organization of public company nature named Subsidy Targeting Organization (the Organization) for implementation of this law in accordance with the FYDP Law, by using the available resources (facilities, manpower and credits) or by restructuring and merging the existing companies. The government is authorized to draw whenever needed the funds deposited to the Treasury as a result of implementation of this law, and make such amounts available to the Organization as aid, after deduction of the government's share as per Article (11) hereof, which amounts will be utilized solely for purposes and obligations specified in Articles (7) and (8) of this law. The Organization's administration will be centralized, and it will be authorized to have only staff, planning, and supervising units in the centre. The members of its General Assembly will comprise Ministers of Welfare and Social Security, Economic Affairs and Finance, Commerce, Roads and Transportation, Agricultural Jihad, Industries and Mines, Petroleum, Energy, and Head of MPO. The company's Organization's articles of association, including its pillars, responsibilities and powers, will be prepared by the Ministry of Economic Affairs and Finance and MPO, and approved by the Ministerial Cabinet. Funds and credits discussed in this law, including in Articles (12) and (15), will be reflected in the country's general budget, like those of other public companies, and changes in the company's Organization's credit ceilings during the year will be subject to providing a proposal by the government and its approved by Parliament, except for the cases authorized in accordance with provisions of this law, including Articles (2) and (14).7. The Organization's unutilized funds in any year could be used in the succeeding year, and in any year it may make commitments for the succeeding years under the framework of this law. Credits governed by this law are subject to the Regulations Governing Spending Credits Exempted from Observance of the Public Audit Law and Other General Government Regulations Law approved on 06/11/1364 (January 26, 1986). The Organization is required to provide reports on performance, receipts and payments related to resources from subsidy targeting, for each of Articles (7) and (8) separately, at the end of each six-month period, to Parliament's Planning, Budget and Audit Committee and other relevant committees. The Supreme Audit Court is required to provide semi-annual reports to Parliament on the Organizations' operations based on the contemplated targets as provided in this law.

Article 16. Starting from the beginning of the year 1389 (March 21, 2010), the government is authorized to increase the tax exemption level provided under Article (84) of the Direct Taxes Law, proportional to price adjustments under this law and in addition to its annual increase, subject to Ministry of Economic Affairs and Finance's proposal, over a period of five years and up to a maximum of 100 percent.

The above law, consisting of 16 Articles and 16 Notes, was approved by the Islamic Assembly on Tuesday, 15 Day 1388 (January 5, 2010) and was confirmed by the Guardian Council on 23 Day 1388 (January 13, 2010).