




## Iran Inflation Surges on Ahmadinejad Subsidies, Price Controls

By Ladane Nasseri



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March 6 (Bloomberg) -- On a deserted Tehran street, an ex-geologist named Reza was hawking black-market fuel from the back of a battered van -- for about four times the legal price.

“I’m a free-marketeer,” said Reza, 48, who asked that his full name not be used for fear of arrest. “Everything in this country works through fixers,” he said as he poured gasoline from a 20-liter jerry can into a car, using a plastic water bottle as a funnel. “That’s because of government mismanagement.”

Iran, the world’s fourth-largest oil producer, is facing gasoline shortages, as well as youth unemployment of 21 percent and U.S. economic sanctions. President

**Mahmoud Ahmadinejad** has responded by imposing gasoline rationing, boosting subsidies and raising government spending, sending **inflation** to its highest annual pace in eight years.

With oil at a record \$104 a barrel, his approach may be affordable for now. That may change, though: Crude-oil prices are forecast to fall 20 percent from current levels by the end of the year.

“They are hemorrhaging money,” said **Michael Rubin**, an Iran analyst at the American Enterprise Institute in Washington. “As long as oil prices are high, the Iranians will grab on to that lifeline rather than pursue the structural changes they need. If oil prices go down further, there will be a real crisis.”

### Election Issue

The economy has become a key issue in the Islamic republic’s March 14 parliamentary elections. Iran’s Reformists’ Coalition, campaigning under the slogan “Control High Prices,” says the government needs to cut the country’s reliance on oil revenue and fight **inflation**, which accelerated to 19.6 percent in December. That is 2 1/2 times the rate the government uses in its planning, and up from 10.9 percent in the month after Ahmadinejad took office in August 2005.

The president, 51, has used Iran’s oil riches to boost his political support. Spending on subsidies for items such as sugar, wheat and cooking oils has increased by more than 50 percent since 2005; the **International Monetary Fund** says gasoline subsidies rose to 16.4 percent of gross domestic product in 2006 from 15.7 percent the previous year.

The budget approved by parliament on Feb. 17 raises expenditures by 25 percent, including an increase of more than 70 percent for construction. In the 2005 Iranian fiscal year, total subsidies equaled one-quarter of GDP, according to the IMF’s March 2007 report.

### Keeping Afloat

All that spending has so far helped keep the economy afloat: Excluding oil production, gross domestic product rose 6.6 percent in the second quarter of last year, down from 7.2 percent in the same period of 2006.

In a move to increase economic efficiency, Supreme Leader **Ayatollah Ali Khamenei** ordered the government in July 2006 to sell 80 percent of the shares of state-owned companies -- which control about 80 percent of the economy -- to the public over the next decade.

Still, the pace of Ahmadinejad’s spending is depleting the country’s treasury. The oil stabilization fund started in 2000 as a cushion against crude-price declines has fallen more than 30 percent in less than two years, to \$7 billion in December 2007, according to the Central Bank of Iran. During the same period, **Russia’s oil fund** grew to \$157 billion.

### Sick and Hungry

The government spending hasn’t created jobs: “Liquidity injected into the economy has led to increased inflation rather than rising employment,” Central Bank Governor **Tahmasb Mazaheri** said Feb. 23 at a meeting with officials from Tehran’s chamber of commerce, the state-run Iranian Students News Agency reported. “All the resources that are being injected are not turning into support for the economy and the sick economy remains hungry.”

The IMF, in its **annual review of Iran’s economy**, called for “phasing out energy subsidies” and stressed “the

importance of addressing the numerous distortions stemming from the extensive controls on prices."

That won't be easy.

"It's a good thing that bread is cheap," said Ghassem Rouzbani, 41, as he handed out loaves of flat Iranian **barbari** bread wrapped in newspaper to customers at the bakery where he works in the Sahadat Abad neighborhood in western **Tehran**. "Otherwise, manual laborers couldn't afford it." A loaf of bread costs 1,000 rials (11 cents).

About a dozen customers lined up at the door of the shop as two bakers behind Rouzbani kneaded piles of dough and a third put them on a revolving brick tray in a gas-fired stove. Above the stove was a picture of Imam Ali, the son-in-law of the Prophet Muhammad and the first imam in Shiite Islam.

#### No Subsidies, No Bakery

"If the subsidies are taken away, this bakery would close," Rouzbani said.

That may hinge on the future course of oil prices. Crude oil is forecast to fall to \$75 a barrel next year, according to the median estimate of 32 analysts polled by Bloomberg News. Merrill Lynch & Co., whose analysts last October correctly predicted oil's rise toward \$100 a barrel, is forecasting \$70 for oil in 2009.

"The government may meet expectations up to a point, but it can eventually result in discontent," said Mousa Ghaninejad, a professor of economics at Iran's Oil Industry University, which is linked to the Oil Ministry.

Meanwhile, the U.S. is pushing international companies and banks to cut economic ties with Iran to punish the country for its nuclear program, choking off investment in the oil and gas industry. The United Nations Security Council on March 3 passed a resolution asking nations to refrain from entering into financial transactions with Iranian banks.

#### Damaged Refineries

Iran's oil refineries, which were badly damaged during the 1980-88 war with Iraq, are unable to meet the country's needs: It must import about 40 percent of its gasoline. Iran pays 52 cents for an imported liter that it sells for about a fifth of that price under the government-run rationing program.

Reza, the self-described "free-marketeer," illegally buys gasoline from service stations at about three times the subsidized price of 1,000 rials a liter. He sells about 350 liters a day at 4,500 rials each to people who have used up their monthly allotment.

"At month's end I get flooded by requests," he said.

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