ireema NEWSLETTER

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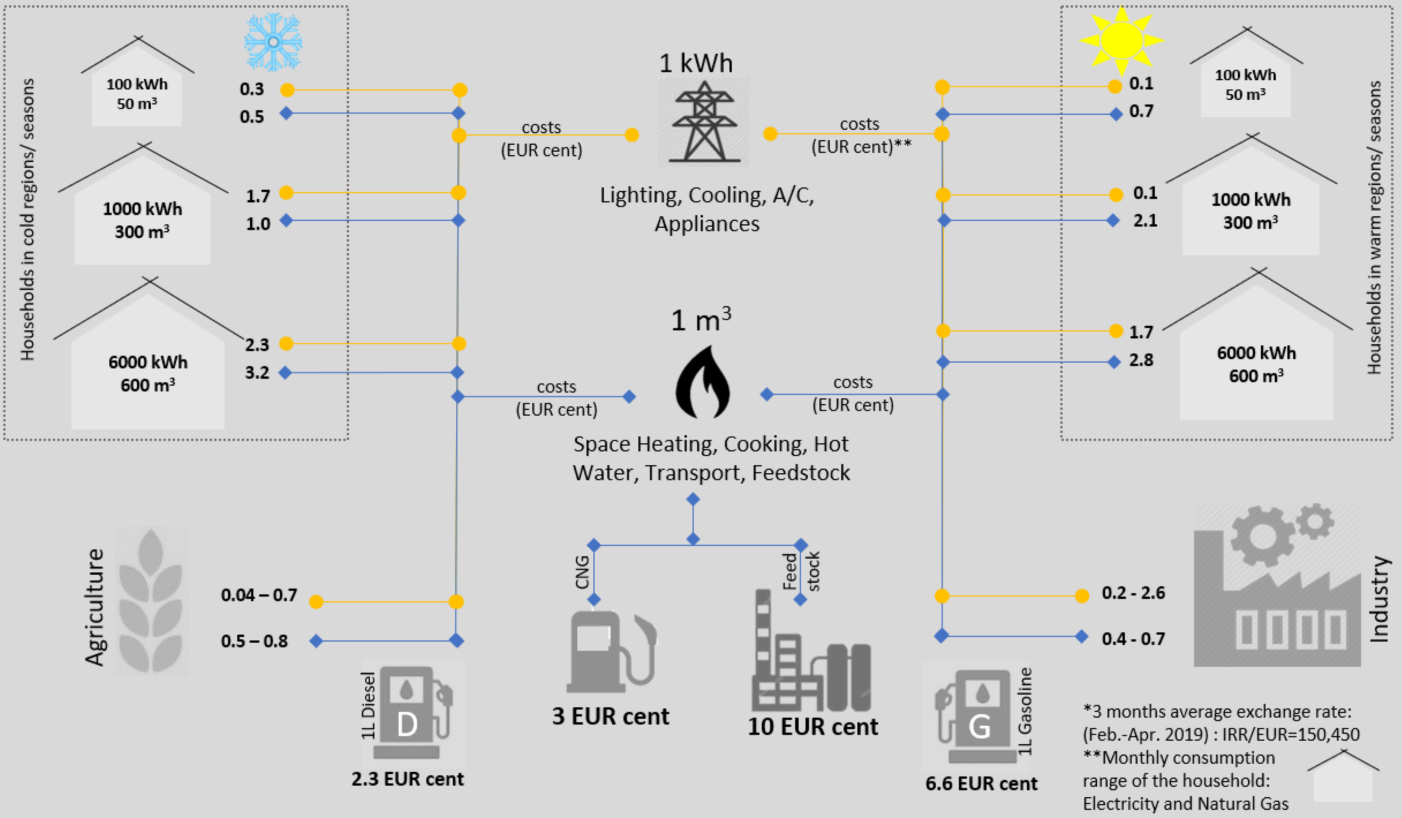
Supporting Iran in implementation of an integrated energy efficiency market

Overview of Energy Tariffs in Iran

Figure 1- A Simplified Picture of Energy Tariffs in Iran



Iran belongs to the countries with the largest oil and gas reserves worldwide. The common belief is that Iranians should benefit from the abundance of energy resources through very low energy tariffs. But low energy tariffs imply subsidies and set adverse incentives for inefficient energy use. In many instances are domestic prices below the cost of production, let alone the large gap to the world market prices for exports of hydrocarbons. Although this has been recognized as a growing problem for the economy and the national budget, Iranian policy makers recoil from general tariff increases fearing social and political turmoil.

Today's structure of energy tariffs is rather complex and distinguishes between different consumers and types of consumption (see Fig. 1).

Electricity

In general, electricity tariffs in Iran are divided into five categories, based on sector and activity: residential, public, agriculture, industrial/mining and other activities. In addition, the tariffs are differentiated according to climate zones, seasons, consumption levels and timing (peak and off-peak loads). Peak electricity loads often occur in summer when demand for cooling is the highest. But current electricity tariffs encourage higher consumption during peak loads.

Electricity tariffs are lowest in the agricultural sector, where electricity is mainly used for irrigation. For the public, commercial and industrial sectors, the situation differs: In addition to a constant monthly fee for power subscription (IRR/kW), companies pay charges for every unit consumed (IRR/kWh), differentiated with *regard to peak, mid-peak and off-peak consumption. Nonetheless, considering the high inflation rates of recent years and only minor increases in energy tariffs, the share of electricity in the total costs of businesses has been shrinking.*

Natural Gas

Similar to electricity tariffs, natural gas tariffs are also differentiated with regard to sectors, levels of consumption, seasons and climate zones. The residential sector accounts for the largest share of total natural gas consumption. At the same time, it pays the lowest tariffs. Only the petrochemical industry, which uses natural gas as feedstock, pays an administered price that is – partly – considering prices on export markets, because significant production shares of petrochemicals are exported.

Petroleum Products

The prices for petroleum products are usually set by the government and parliament in the Annual Budget Plan. Current prices are very low in international comparison (see Fig. 1 and Fig. 3).

Figure 2- Electricity (kWh) and Natural Gas (m3) Price in IRR (Average of Sectors) 2005-2016

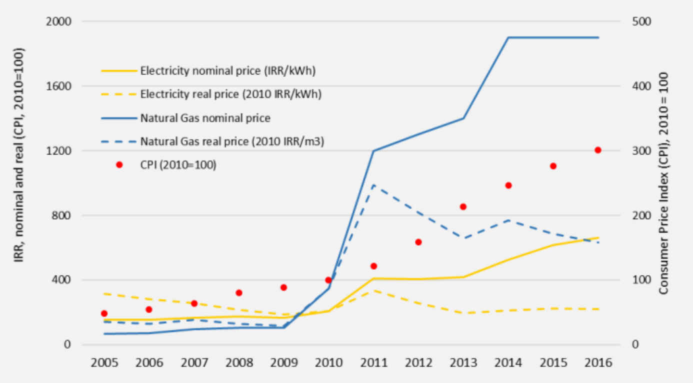
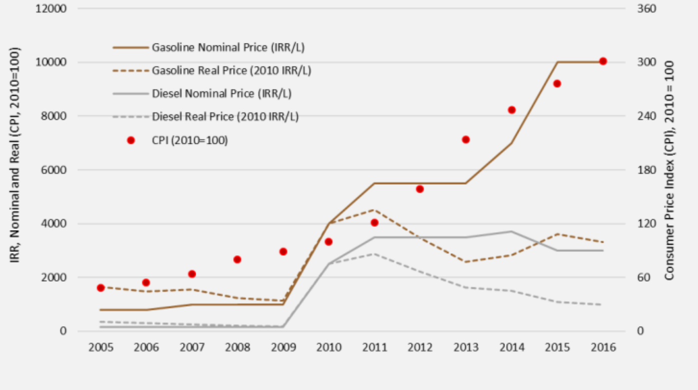


Figure 3- Gasoline and Diesel Prices 2005-2016 (IRR/L)



Economic consequences of the current tariff system

In a market economy, prices signal the opportunity cost of using a specific good as input or for final consumption. But in Iran, the energy tariffs are influenced by political and social and less by economic considerations. For years, energy tariffs were set below the consumer price inflation (see Fig. 2 and Fig. 3). Hence, the energy intensity of the economy has been rising, and so has the burden on the national budget.

The differentiated tariff system fails to cover the actual cost of energy supply and prevents the efficient allocation of energy resources. Energy tariffs do not reflect the opportunity cost of alternative energy use, like in terms of foregone export earnings. The International Energy Agency (IEA) estimated energy subsidies in Iran at around 45 billion USD, 18 percent of GDP, in 2017. By improving energy efficiency and reducing domestic consumption, and by raising exports instead, Iran could greatly increase the revenues from extracting hydrocarbons. This also alleviates the environmental impact of fossil energy use in Iran.

Past efforts to increase energy tariffs in Iran failed because of poor implementation. In 2011, the plan was to remedy a tariff increase through targeted subsidies to the poor. But the targeting was not limited to the poor, but almost any individual could register for the payback. The payback turned into a fiscal stimulus injected in the rigid closed economy of Iran. This resulted in high consumer price inflation outpacing previous tariff increases. Since then, increases of energy tariffs are considered a political taboo in Iran. Instead, a unique approach is under development based on the existing tariff differences: The Market for Energy Efficiency and Environment (M3E), approved by the Supreme Energy Council of Iran on 19 February 2018, will allow investors to sell energy savings to higher-tariff consumers. The M3E mechanism could correct the distorted allocation of energy in Iran, channeling resources to more efficient use.

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