Economist Intelligence Unit Briefing

A fuel pinch

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Iran, Jordan and Syria each need to cut fuel subsidies

The flip side of the Middle East oil boom has been the exponential rise of the costs that most of the region's governments have faced in subsidising domestic energy demand—which is growing by more than 5% per year across the region. However, tackling these subsidies comes at a political price, as the governments of Iran, Jordan and Syria have recently become painfully aware. In Iran, the imposition of gasoline rationing provoked sporadic riots and has contributed to the increase in tensions within the government, as reflected in the recent replacement of the oil and planning ministers and the central bank governor. The Jordanian finance minister recently resigned after he was prevented from raising gasoline prices, and the Syrian government is bracing itself for a backlash as it prepares to announce steep increases in fuel prices.

Double rations

Iran's move to curb fuel consumption through rationing was motivated to a large extent by national security considerations, as the failure of the domestic refining sector to keep pace with rampant increases in demand has made Iran increasingly dependent on imports of petroleum products. Prior to the rations going into effect at the end of June, Iran was consuming some 75m litres of gasoline per day, while its refineries were producing on 44m litres/day. The gasoline import bill in the 2006/07 financial year was more than US$5bn. The rations appear to have succeeded in moderating demand, although it is too early for a consistent to pattern to have emerged. However, the government has refused to make available extra fuel at market prices to drivers that have used up their rations, and has decided instead to double the 100-litre/month ration for private cars for the late-summer holiday season. The price of subsidised gasoline has been increased (from 9 to 12 US cents per litre), but this is still only a fraction of the effective import price of about 50 US cents/litre. The rations have, moreover, been presented as a temporary measure, to be imposed for four months. Ultimately, Iran will be unable to address the interlinked problems of subsidies and smuggling unless the basic price of gasoline is increased by a substantial margin.

Blame Iraq

The political fall-out from Iran's ration scheme has been, to a large extent, an exercise in shifting blame from the centre of power—the president, Mahmoud Ahmadinejad, and the supreme leader, Ayatollah Ali Khamenei—to ministers and civil servants. In the cases of Jordan and Syria, Iraq has proved a useful scapegoat amid the controversies over fuel subsidies. Jordan benefited for years from supplies of cut-price oil from Iraq, but these have dried up since the 2003 invasion, and the government has been obliged to increase fuel prices several times to prevent the budget deficit from ballooning out of control. The finance minister and deputy prime minister, Ziad Fariz, resigned in late August after his recommendation that a fresh round of fuel prices was needed was turned down by the prime minister, Marouf Bakhit. With a general election scheduled to take place in November, Mr Bakhit's position was understandable, although Mr Fariz warned that without a price hike, the fiscal deficit is likely to be in the region of US$1bn, almost double the original target. The government is banking on Gulf Arab states to provide some relief.

In Syria, the government has invoked the additional demand pressures caused by the influx of 1.5m Iraqi refugees among its justifications for trimming fuel subsidies, which are estimated to cost the state more than 10% of GDP.

Bashar's test of nerve

Although the Iraqi influx has undoubtedly contributed to the budgetary pressures in Syria, the critical issue is the decline in Syria's own oil production from a peak of almost 600,000 barrels/day in the late 1990s to about 380,000 b/d now. According to government figures presented by the IMF in its recently released Article IV report, Syria's oil balance—crude oil exports minus petroleum product imports and royalties to foreign operating companies—has moved from a surplus of US$2.5bn in 2003 to a projected deficit of US$53m in 2007.

The Syrian president, Bashar al-Assad, has entrusted Abdullah al-Dardari, the deputy prime minister for economic affairs, with the task of pushing through the cuts in fuel subsidies, as part of a strategy of transforming Syria into a market economy and weaning the state off its former reliance on oil export income. Mr Dardari has taken credit for the robust performance of Syria's non-oil economy over the past three years, which has been based on a combination of domestic liberalisation, strong investment flows from the Gulf Arab states and capital inflows associated with the Iraqi influx (estimated at US$2.5bn between 2004 and 2006 by the IMF). However, Mr Dardari now runs the risk of being targeted by critics of any fuel price increases that are put into effect. The question then will be whether Mr Assad will continue to provide political cover for the standard bearer of his economic reforms, or whether Mr Dardari will suffer the same fate as his fellow ministers in Jordan and Iran. The Syrian government is aiming to soften the blow of the fuel price hikes by awarding cash compensation of US$250 per family and increasing civil service salaries by 15-20%. If the stratagem works, Mr Dardari could be rewarded by becoming Syria's first non-Baathist prime minister since the party seized power in 1963.