The dilemma of cheap food and self-sufficiency: The case of wheat in Iran

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Abstract

Self-sufficiency in wheat has been one of the major goals of Iranian agricultural policies since the Revolution of 1979. Even so, the country failed to achieve this goal by the early 2000s, despite a satisfactory growth in wheat production. This paper addresses this failure and the political difficulties in introducing reforms that would reduce the need for import. First, the production and consumption of wheat are examined. The conclusion is that the cheap-bread policy has mainly been responsible for the imbalances between domestic supply and demand, and the continued reliance on wheat imports. Moreover, the paper argues that the subsidy program is an expensive safety net for the needy and shows that the Iranian government has intended to reform the program since the early 1990s. However, subsidy reforms are politically sensitive, especially in developing countries where subsidies are considered very important, both for supporting the poor and for political stability. An analysis of the Iranian attempts at subsidy reform suggests that they have not yet succeeded, mainly due to such political considerations.

Keywords: Food self-sufficiency; Wheat and flour price; Wheat consumption; Leakage; Food subsidy; Subsidy reform
Introduction

Food security has been an important goal of agricultural policies in many countries. The most common rationales behind such efforts have been concerns about the potential risk of a global shortage of food and the importance of food for a nation’s defense. The Iranian agricultural policies have aimed at food self-sufficiency on similar grounds after the Revolution of 1979 and eliminating wheat imports has been regarded as the first and most important step for achieving this goal. Wheat is the staple element of the national diet and more than 60% of the country’s arable land are under wheat cultivation.

The government has employed a package of various measures to encourage wheat production in order to reduce wheat import. The production has also responded favorably and has increased rather satisfactorily since the Revolution. Nevertheless, the country did not achieve self-sufficiency in wheat by the early 2000, mostly because of a generous subsidy system and the political complexity of reforming it.

Although there is a rich literature on food policies and subsidy reforms in developing countries, there are few published studies in the case of Iran. The aim of the present paper is to fill some of this gap by addressing two issues concerning the Iranian wheat and bread policy. First, it examines the role of the bread subsidy program in the failure to attain wheat self-sufficiency. Second, it analyzes the efforts to reform the program since the early 1990s. The latter are especially important since little has been achieved despite the fact that the program is believed to be excessively costly and an obstacle to the fulfillment of self-sufficiency. Some of the analyses here are based on reports, statements and interviews published in the press, since the political sensitivity of the question sometimes limits the access to necessary empirical evidence.

The paper is organized in the following way. The next section briefly discusses the theoretical framework behind conventional self-sufficiency policies. It also highlights some of the consequences of such policies, based on the experience of other countries. The paper then turns to the case of Iran and argues that the cheap-bread system has been the main cause of excess demand in the domestic wheat market and a continuous dependence on imports. The following section examines the difficulties in reforming the cheap-bread policy despite stated plans for reform. Finally, the concluding remarks are presented in the last section.

The economics of self-sufficiency

It is very common to control prices of agricultural products to direct their production and consumption. An easy way of discussing the effects of price policies is the equilibrium analysis of the market for a commodity such as wheat. Assume that Fig. 1 illustrates the wheat market. In equilibrium, the price is $P_e$ and production is equal to consumption ($Q_e$).

If a government wants to encourage production, it can determine a minimum price, a price floor, for wheat and guarantee to buy it at the specified price. The price floor, $P_{\text{min}}$, is then set higher than the equilibrium price and increases production and reduces consumption. The result is a surplus equivalent to AB. The government must buy the surpluses, which it may store or export.

In contrast, price ceilings could be employed to support consumers. The price ceilings are fixed under the equilibrium price, for example $P_{\text{max}}$ in Fig. 1. Such a price reduces
domestic production, increases consumption and causes shortages equivalent to CD. The country can deal with such shortages through rationing or wheat imports.

There is a contradiction between the two price policies with respect to self-sufficiency. Minimum prices tend to generate surpluses and contribute to self-sufficiency, while maximum prices lead to shortages and increase the need for wheat imports. Then, a government employing both policies simultaneously and driving for self-sufficiency places itself in somewhat of a dilemma. Theoretically, it is possible to find pairs of prices leading to self-sufficiency. In terms of Fig. 1, policymakers should first specify the desired consumer price, \( P_{\text{max}} \), and then determine a matching \( P_{\text{min}} \) that equals production (\( P_{\text{min}}B \)) with consumption (\( P_{\text{min}}D \)). However, it is difficult to determine such pairs of prices in practice. The eventual outcome may still be more ambiguous if changes shift demand and/or supply. For example, changes in income and relative prices might increase the demand for wheat, shift its curve outward, and increase CD.

The cases discussed above are the most conventional examples of price interventions and there are virtually many different mixes of the policies. For instance, if the price of wheat imports is \( P_{\text{max}} \) in an open economy, the government may support its producers by determining a price between \( P_{\text{max}} \) and \( P_{e} \). In any case, standard economic theory shows that price interventions would generally lead to resource misallocation and there are often less costly alternatives.\(^1\) The cost of price controls may increase due to administrative expenditures, mismanagements and corruption.

Price policies can also imply a fiscal cost for the government. For example, the government is sometimes forced to export the surpluses, AB in Fig. 1, at cheaper prices than \( P_{\text{min}} \) and cover the difference. On the other hand, the government must subsidize its cheap-food policy when CD is imported at higher prices than \( P_{\text{max}} \). Similarly, when a government uses both minimum and maximum prices, it must finance the wedge between these prices. The higher the difference between producer or import and consumer prices, the larger is the required food subsidy.

\(^1\) The basic model is presented in all microeconomic textbooks. See, for example, Besanko and Braeutigam (2005). See also Demekas et al. (1988) for an accessible discussion of price supports and a review of some empirical studies.
Food price policies, production and consumption in practice

There is a rich experience of food price policies in both developed and developing countries. In developed countries, the principal goal of the policy is to guarantee a certain level of domestic production, or sustain a larger number of people in the agricultural sector than what would be the case without interventions (Swinbank, 1992). In the US, the supportive prices led to wheat surpluses, which were granted to developing countries as food aid, sold at concessional prices, or sold on the world market at lower prices than the domestic prices during the 1950s and 1960s (Friedmann, 1982). Price supports have also been one of the major components of the European Union’s Common Agricultural Policy and have substantially limited the import of many agricultural products in the EU (Demekas et al., 1988; Swinbank, 1992).

In developing countries, on the other hand, price ceilings for basic foods are widely used since the governments are keen not to leave the provision of adequate food supplies to the market forces, given the low level of food consumption of the poor (Alderman, 1986; Ahmed and Mellor, 1988). This may partly explain why a large number of these countries relied more or less on food imports by the 1980s (Paulino, 1986; Wegner and Stork, 1990). Experience from countries such as Brazil and Zambia that tried to counteract the effect of a price ceiling by offering incentive prices to producers shows little success in reducing food imports (Calegar and Schuh, 1988; Kumar, 1988).

Generally speaking, poor performance of the agricultural sector cannot always explain the constant reliance of many developing countries on imports. Cereal production grew faster than population growth but fell short of consumption growth, which led to a steep upward trend in imports in these countries between 1961 and 1982 (Paulino, 1988). Growth in per capita income is often pointed out as the major reason behind rapid growth of demand for cereal (Mellor, 1983; Paulino, 1988; Von Braun and Paulino, 1990).

Yet, the impact of cheap-food policies on increases in consumption should not be ignored. For example, Egypt and Tunisia have generous food subsidy systems and the per capita consumption of wheat for food and waste increased in both countries during 1980s and 1990s. Both indicators declined in the Middle East as a whole during the same period (FAO, 2004). The following section discusses the Iranian experience of price policies and self-sufficiency efforts in wheat.

Wheat price policies and self-sufficiency in Iran

Although achieving agricultural self-sufficiency was mentioned in most economic programs before the Revolution, it became a central goal afterwards (McLachlan, 1986). A major objective of post-revolutionary agricultural policies has been to increase the production of staple crops, especially wheat which is perceived to be the key to agricultural self-sufficiency (Aftab-e Yazd, 17 November 2004; Schirazi, 1993). Price incentives have been one of the main measures employed to encourage wheat production.

Administering the price of wheat goes back to before the Revolution. A fixed-price system was set up to support both producers and consumers. In practice, the system mainly favored urban consumers and discouraged producers since, among other things, official prices were relatively low (Amid, 1990; Shafaeddin, 1988). The revolutionary government increased the producer price of wheat by about 50% immediately after the Revolution.
This price has been regularly raised since then. On the other hand, the price of flour sold to bakeries has been strictly checked and has remained very low (see Table 1).

Extensive interventions in the wheat market gradually turned the government into the principal agent in this market after the Revolution. The government buys wheat from farmers at guaranteed prices, mills it, and sells the flour to bakeries and other producers at specified price ceilings (*Hamshahri*, 20 July 2002). The price of flour has always been lower than its cost and the difference has been financed by subsidies.

**Wheat production trend**

Although there has been a sharp increase in the producer price of wheat on several occasions, it has tended to fall behind the inflation rate rather quickly. As a result, the real price of wheat has seldom been attractive (Mojtahed and Esfahani, 1989; Najafi, 2001; Salami and Eshraghi, 2002). The price was sometimes very low and worked as a distinctive while wheat was imported at a higher cost than the price floor (*Hamshahri*, 12 March and 20 July 1997; Sharagh, 16 November 2004).²

On the other hand, government’s modernization policies encouraged farmers to employ more mechanical and biological inputs, which had a favorable effect on wheat production (FAO, 2004; Gharebaghyan and Homyounfar, 2002; Ministry of Agriculture, 1999; Najafi, 2001). In the case of wheat, production grew at an annual rate of 3.1% after the Revolution. The record stands well if compared with the averages in either the Near East or in developing countries as a whole (FAO, 2004).

More relevant for our purpose is production per capita. Between 1979 and 2002, the per capita production of wheat shows a slightly upward trend (see Fig. 2). Put differently, wheat production grew more rapidly than the population in this period and imports of wheat should have declined or remained unchanged. On the contrary, Fig. 2 illustrates a strong upward trend in the imports of wheat per capita, which implies that consumption per capita must have increased significantly after the Revolution.

**Developments of wheat consumption**

Wheat is mainly used for food, livestock feed, and seed, and part of it is lost in production and consumption processes. Table 2 shows that all components of demand for wheat

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² In terms of Fig. 1, if $P_{\text{min}}$ is determined below $P_e$, producers will reduce the production of wheat.

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Table 1

<table>
<thead>
<tr>
<th>Year</th>
<th>Wheat</th>
<th>Flour</th>
<th>Wheat-flour difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>57</td>
<td>37</td>
<td>20</td>
</tr>
<tr>
<td>1990</td>
<td>100</td>
<td>42</td>
<td>58</td>
</tr>
<tr>
<td>1993</td>
<td>225</td>
<td>43</td>
<td>182</td>
</tr>
<tr>
<td>1996</td>
<td>410</td>
<td>54</td>
<td>356</td>
</tr>
<tr>
<td>1997</td>
<td>672</td>
<td>40</td>
<td>635</td>
</tr>
<tr>
<td>2002</td>
<td>1300</td>
<td>40</td>
<td>1260</td>
</tr>
</tbody>
</table>

Source: *Barnameh* (19 October 2002).
grew rather rapidly in post-Revolutionary Iran except wheat for seeds which decreased slightly. There are reasons to believe that the cheap-bread policy has played an important role in speeding up the demand for wheat. This is investigated in greater detail in this section.

The major component of wheat demand in Iran is wheat for food, which constitutes more than 80% of the wheat consumption and is predominantly used for bread. The Iranian population grew at about 2.5% annually between 1979 and 2002 (FAO, 2004). Table 2 shows that the annual growth rate of the consumption of wheat for food was 3.3% during this period, which implies that the per capita consumption of wheat for food increased after the Revolution. Changes in income can hardly explain this growth rate. First, esti-

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Table 2

<table>
<thead>
<tr>
<th>Years</th>
<th>Food</th>
<th>Feed</th>
<th>Waste</th>
<th>Seed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979–1981</td>
<td>5728.5</td>
<td>416.7</td>
<td>347.6</td>
<td>761.1</td>
</tr>
<tr>
<td>1982–1984</td>
<td>6731.1</td>
<td>608.3</td>
<td>426.3</td>
<td>742.9</td>
</tr>
<tr>
<td>1985–1987</td>
<td>7609.6</td>
<td>676.7</td>
<td>483.9</td>
<td>803.8</td>
</tr>
<tr>
<td>1988–1990</td>
<td>9481.6</td>
<td>830.0</td>
<td>535.9</td>
<td>789.2</td>
</tr>
<tr>
<td>1991–1993</td>
<td>9835.8</td>
<td>1360.3</td>
<td>637.4</td>
<td>864.0</td>
</tr>
<tr>
<td>1994–1996</td>
<td>9951.1</td>
<td>2133.3</td>
<td>690.2</td>
<td>793.4</td>
</tr>
<tr>
<td>1997–1999</td>
<td>11,010.0</td>
<td>2366.7</td>
<td>771.8</td>
<td>662.1</td>
</tr>
<tr>
<td>2000–2002</td>
<td>11,732.4</td>
<td>2360.0</td>
<td>785.6</td>
<td>756.2</td>
</tr>
</tbody>
</table>

Average annual growth rate (%) 3.3 9.4 4.0 –0.2

*Source: FAO (2004).*
mates show that demand for bread is relatively insensitive to income changes in Iran.\(^3\) Second, income per capita has decreased in the first decade after the Revolution and grew slowly during the 1990s followed by more rapid growth rates in the 2000s (World Bank, various issues).

On the other hand, Table 1 indicates that the government raised the price of flour very slowly, which has contributed to check increases in the price of bread.\(^4\) There have been increases in the price of bread mainly in response to other costs such as wages, and the flour cost has gradually become a negligible part of the total cost of bread (Barnameh, 24 April 2004). As a result, the price of bread increased less than other food prices after the Revolution (BMI, various issues).

The growth of per capita wheat consumed for food may partly reflect the substitution of bread for other, more expensive food (cf. Dini Torkamani, 1995). A case in point is an increase in the share of bread as the source of daily calorie of a household from 34% to 46% in urban areas between 1977 and 1989. The equivalent data for rural areas was 53 and 59, respectively (Rasoolof, 1993).

Table 2 also shows that the amount of wheat fed to livestock grew very quickly after the Revolution. The growth in the production of livestock products in response to population growth and income increases in recent years may explain part of the upsurge of the use of wheat for feed.\(^5\) Nevertheless, the official price of wheat was sometimes lower than other animal feed, which could have contributed to increased demand for wheat for feed (Hams-hahri, 20 July 1997 and 4 May 1998).

Finally, Table 2 reveals that an increasing amount of wheat has been lost during transportation, storage and processing since the Revolution. More precisely, the wastes during distribution grew by an average rate of 4% per year and more than doubled between 1979 and 2002. Officials maintain that these wastes are mainly the result of technical deficiencies such as primitive storage facilities and baking methods (Kalantrari and Khademadam, 1994a,b, 1996) Yet, the relatively low price of wheat might have had an adverse effect on the efforts to reduce such wastes. For example, modernizing baking methods requires investments, which are often more costly than wastes to bakeries (Barnameh, 18 January 2003).

There are also losses during consumption. They mainly arise because the bread is often not properly baked and consumers do not conceive all of it as edible (Hamshahri, 30 November 1996; 24 May 1997; 8 and 9 June 1998). Moreover, many consumers complain that the bread does not keep well, goes stale and becomes inedible rather quickly (Hamshahri, 2 December 1996). Official reports frequently maintain that about one third of the bread is wasted by the consumers. This is roughly more than 20% of the wheat production.\(^6\) However, case studies show household waste of bread to vary greatly between places, and it may lie between 8% and 33% of the bread bought by consumers (Abedi

\(^3\) Dini Torkamani’s (1995) estimates show the income elasticity to lie between 0.22 and 0.38. Mohsenin (1995) shows it to be as low as 0.02 in Tehran.

\(^4\) The ceiling price of flour used for bread has always been lower than its official price for non-bread production. In 2002, for example, traditional bakeries paid 40 rials while cake and cookie producers were to pay 1050 rials (Hamshahri, 5 January 2002).

\(^5\) For instance, the production of milk and red meat increased by about 90% and 80%, respectively, between 1981 and 2001 (SCI, 1995 and 2002).

\(^6\) For some examples, see Hamshahri (2 December 1996; 30 September 2000) and Iran Daily (18 December 2001).
It should be mentioned that all bread wastage is not lost since part of it is recycled. Peddlers carrying piles of stale, dried bread is quite a common scene in large cities in Iran. They exchange salt and other low value goods in exchange for the bread waste, which is later sold for other purposes such as livestock feed.

There is no direct evidence that cheap-bread policy affects consumption wastes. In fact, the few case studies available find that other factors such as household size and the frequency of purchasing bread each day affect the bread wastage more than its price (Abedi Shoupor Abdi, 1995; Arsalnbod and Mehrnia, 2001; Mohsenin, 1995). The results of a questionnaire in Tehran also indicate that only a small fraction of respondents believed that the price of bread would influence their bread wastes. Nevertheless, the number of respondents stating that they would reduce their wastes increased as they were faced with scenarios of price increases as high as 300% (Mohsenin, 1995). This may, in fact, show that the price is important but the real price of bread is relatively low and consumers perceive moderate, realistic price increases to be rather irrelevant for their waste decisions. On the other hand, radical price increases would influence the choice. Moreover, it seems that the controlled price of bread combined with few substitutes for cheap bread and the absence of competition among the bakeries have reduced the incentives to supply good quality bread, which would reduce bread wastages (Hamshahri, 30 November 1996; 1 December 1996; 24 May 1997; 26 February 1998; and 23 January 2006).

Benefits, costs and the need for reform

We saw earlier that the Iranian wheat price-policy has had little impact on wheat production, but it has provided cheap bread for the whole population. The latter has been very important for low-income families since a considerable proportion of them would have fallen under the poverty line without the bread subsidy program (Dini Torkamani, 1995). A major drawback of the system is that it encourages leakages, i.e. wastes and diversion of subsidized flour into other purposes than those intended. The larger the leakages, the higher the costs of supporting the poor.

The importance of wheat wastage has already been discussed. There is also evidence of subsidized flour being diverted to non-intended uses. The officials frequently maintain that some of the bakeries receiving the heavily subsidized flour sell part of it to producers of less-subsidized goods such as cakes and cookies (Hamshahri, 11 December 2002 and 24 August 2003; Shargh, 27 July 2004). Moreover, they argue that wheat and flour are smuggled to neighboring countries with considerably higher prices (Barnameh, 18 January 2003; Hamshahri, 12 June 1997 and 11 December 2002). There are no reliable estimates of the magnitude and costs of leakages, but they could really be substantial considering the reported profitability of the diversion (Barnameh, 1 November 2003; Hamshahri, 26 February 1998; 5 January 2002; 16 June 2003; and 23 August 2003). The experiences of other countries with food subsidies such as Egypt and Morocco also show that leakages tend to be significant (Ahmed et al., 2001; Gutner, 2002; Kennedy and Alderman, 1987).

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7 In addition to distribution and consumption waste, some wheat is lost during production, which is estimated to lie between 2% and 7% in Iran (Hamidnejad et al., 2001; Hamshahri, 24 May 1997).

8 Reports indicate that this is a rather large business, and engages a lot of people in Tehran (Hamshahri, 9 June 1998; Iran, 26 and 27 July 2003).
The Iranian bread system becomes even more expensive because wheat and flour markets are strictly regulated. This marketing structure implies that farmers sell wheat to the government, which stores and mills it in urban areas, and then transports it back to rural bakeries (Hamshahri, 25 February 2006). Estimations of the costs of such a circuitous flow for several African countries show that they could be rather high (Jayne and Jones, 1997).

The system also places an increasing financial burden on the government budget (see Table 1). Bread subsidies increased from less than 1% to 6.5% of the government current expenses between 1979 and 2001. As a result, wheat subsidies increased from 19% to 65% of the total subsidies paid on essential goods during the same period (BMI, 1983 and 2001). The statistics do not include the subsidies paid for agricultural inputs, such as fertilizers and tractors. It is believed that the government virtually paid about 2500 rials for each kilo of wheat in 2002, if all subsidies were included. This was almost twice as much as the guaranteed price of wheat in the same year (Barnameh, 1 November 2003).

All in all, the cheap-bread program in Iran seems to be an unnecessarily expensive social safety net. Evidence from many other universal subsidy systems lends support to such a conclusion. For example, the rice subsidy system in the Philippines required approximately 4.3 to 6 pesos to transfer one peso to the poor (Subbarao et al., 1996). In Egypt, the ratios of cost-income transfer to the needy were about 3 and 3.7 for the bread and flour subsidy schemes, respectively (Ahmed et al., 2001). Analyses of various programs also suggest that targeted subsidies may help the poor at lower costs (Löfgren and El-Said, 2001; Rogers, 1988; Pinstrup-Andersen, 1988; Subbarao et al., 1997). Iranian policymakers have recognized these facts and decided to reform the system in the early 1990s, so far without much success. The next section addresses the attempts to reform the cheap-bread system and their failure.

Reforming the bread policy

Let us review some of the lessons that can be drawn from studies on economic and subsidy reforms before turning to the Iranian experience. First and foremost, the literature indicates that economic efficiency is not sufficient to introduce or successfully carry out a reform. Reforms may be delayed by other considerations such as the distribution of gains and losses or the possibility to transfer the costs of reforms to rival groups by waiting for them to carry out the reforms (Alesina and Drazen, 1991; Fernandez and Rodrik, 1991; Przeworski, 1991). The government commitment to provide cheap food may also affect a reform process concerning food subsidies. Such commitments can constitute part of system imperatives and may be introduced, for example, when a socialist or populist government comes into power (Alderman, 1986; de Janvry and Subramanian, 1993). The authorities may then hesitate to reform the system, which usually implies subsidy cuts and price increases, since it can be interpreted as betraying the promises. Public responses depend, among other things, on the prevailing political system. They are likely to be more destabilizing the less democratic is a regime (Rodrik, 2000).

Bienen and Gersovitz (1986) also show that subsidy cuts may or may not be followed by violent reactions and riots. The riots rarely resulted in lasting political destabilization but historical experience shows that such protests may still trigger a chain of events that can lead to important political reforms or regime changes (Bienen and Gersovitz, 1986; Gutter, 2002; Hopkins, 1988; Walton and Seddon, 1994).
There are then reasons to try to moderate the expected reactions to a subsidy reform, especially in less participatory political systems and when latent public discontent may exist. Governments’ strategy may include various measures: (i) carefully explaining the reasons for the reform, (ii) gradual reduction of the subsidies and moving to higher prices, (iii) targeting the diminished subsidies towards the politically most demanded groups, and (iv) avoiding direct price increases and considering alternative options (Bienen and Gersovitz, 1986; de Janvry and Subramanian, 1993; Gutner, 2002).

The initial reform steps in Iran: non-price measures

The Iranian government started a typical IMF-stabilization reform in the early 1990s, which, among other things, aimed at reducing the subsidies (Behdad, 1995). This has remained a major goal of successive economic programs since then (Management and Planning, 1999, 2005). On the other hand, the Islamic Republic wants to guarantee the supply of cheap bread to the poor, since it has persistently advocated an ideology of pro-poor and social justice from the very beginning. Ayatollah Khomeini repeatedly pointed out that the Revolution belongs to the poor and that the government had to do everything to support them. He evidently required the authorities not to raise the price of essential goods, especially the price of bread (ISNA, 30 April 2004). His successor, Ayatollah Khamenei, and successive governments have followed the same line and there are also influential political groups opposing price increases. Last but not least, supporting the needy is explicitly required by Articles 3 and 43 of the Constitution of the Islamic Republic.

As a result, increasing the price of bread, i.e. the staple food of the poor, is very offensive to politicians. This was especially true in the early 1990s. The war with Iraq had recently ended and the country had experienced a decade of populist, distribution-oriented policies. This may partly explain why the early policy recommendations to reduce bread subsidies emphasized non-price options (Hamshahri, 24 May 1997).

Another decisive reason for avoiding price discussions has certainly been the political risks that could follow price increases in subsidized goods. The experience in other Middle Eastern countries, in general, and in Iran, in particular, in fact demands a cautious approach to reforms. Subsidy reforms provoked popular political unrest in Egypt, Morocco, Sudan and Tunisia between 1977 and 1985 (Alderman, 1986; Bienen and Gersovitz, 1986; Seddon, 1984). Iran itself has experienced a relatively large number of riots and anti-government protests in modern times and a documented unrest because of dissatisfaction with the bread supply (Banks, 1972; McFarland, 1985). More recently, partial cuts in the subsidies of certain foodstuffs, as part of the post-war stabilization program, led to a wave of protests and demonstrations in several large cities (Walton and Seddon, 1994). The Management and Planning Organization, which has been the major official agency advocating subsidy reforms, acknowledges the potential risks of sudden subsidies cuts and its director maintains that ‘subsidy reform requires courage’ (Barnameh, 11 November 2003; Hayat-e no, 5 January 2005).

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9 This is clearly reflected in www.imam-khomeini.com, where there are many statements in support of the needy.

10 For some examples, see Hamshahri (31 July 1996, 1 January 2001; 13 April 2003; 26 August 2004; and 1 November 2005).

11 For an English translation of the Constitution see www.salamiran.org/IranInfo/State/Constitution.
Finally, the insufficient insight into the importance of prices for bread consumption could have contributed to overlooking prices at the initial stage of subsidy reforms, i.e. in the early 1990s. This is partly reflected in a series of articles written by Kalantari, at that time the Minister of Agriculture, and Khademadam (Kalantari and Khademadam, 1994a,b, 1996). They argue that the continuous import of wheat is principally explained by high wastes caused by technical deficiencies. The main proposed solution is to modernize the planting, harvesting, transportation, and processing of wheat.12

In practice, the government encouraged the mechanization of bakeries in the capital and some large cities in the 1990s, but it has not succeeded in reducing the wastes. On the contrary, the reports show that the bread supplied by these bakeries was of low quality and led to increased wastes (Hamshahri, 30 November; 1996; 12 March 1997; and 9 June 1998).

The government also tried to better target bread subsidies by allowing the establishment of so-called ‘free-baking’ bakeries in the well-to-do areas in the large cities. These bakeries receive flour at higher prices than other bakeries, and are allowed to sell the bread at higher prices. In 2003, these bakeries paid more than an eight times higher price for the flour and could sell the bread at about 1.5 times more than traditional bakeries (Iran, 17 August 2003). The subsidy to rich people would decrease if they bought bread from these less-crowded bakeries. However, this strategy could have hardly had any noticeable effects since only 200 out of 7500 bakeries in Tehran were ‘free-baking’ as late as in 2000 (Hamshahri, 10 July 2000).

Targeting subsidies and price increases

The government has begun to consider both price increases and targeting the subsidies more seriously since the mid-1990s. The targeting ambition was clearly expressed in the Second Development Plan, 1995–1999 (Management and Planning Organization, 1999). However, little has happened under this plan and the project reappeared in the Third Development Plan, 2000–2004. This time, the Plan required the government to take the necessary steps to make subsidies targeted from the third year of the Plan (Management and Planning Organization, 2005). The Management and Planning Organization itself was supposed to develop a data base that could be used for this purpose (Management and Planning Organization, 2001). The Organization also considered different ways of dealing with the subsidy problem: targeting after identifying different income groups, direct cash payment to everybody or payment by means test (Hayat-e no, 5 January 2005).

Official statements and documents indicate that the government opted for gradual price increases irrespective of the method chosen (Barnameh, 1 November 2003; 20 July 2002; and 1 February 2003; Hamshahri, 20 July 2002). Furthermore, there were plans to launch an extensive campaign in the early 2003 to inform the people of the necessity of the reform and its likely impact on prices (Hamshahri, 1 February 2003). In practice, the government had begun such a campaign in the early 2000s. The officials frequently mentioned the drawbacks of the subsidy system and the benefits of reforming it. The key term was ‘mak-

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12 They maintain that to some degree, ‘over-consumption’, namely consumption of food beyond defined nutritional limits, is also a problem. This is regarded as a socio-cultural problem that could be dealt with by creating a new consumption pattern.
ing subsidies targeted’. The subsequent price increases were approached implicitly and cautiously at the beginning but were later brought up more explicitly and frequently.\(^{13}\)

The government, however, had little success in formulating a policy for carrying out the ‘targeting’ program as planned. Identifying the targeted groups is maintained to have been the major obstacle to the program (\textit{Hamshahri}, 22 September 2004). The failure of the Management and Planning Organization to deliver the necessary data has often been attributed to insufficient information and difficulties in collecting such information (\textit{Hamshahri}, 1 February 2003; 6 October 2004; \textit{Iran Daily}, 26 December 2004; \textit{Hayat-e no Eqtesadi}, 10 November 2004).

While still pondering over a comprehensive reform program, the government decided to take a step toward cautiously controlling the growth of the subsidies in 2003. An increase in the price of subsidized goods, including flour, was proposed in the budget bill of 2003, which was passed by the parliament (\textit{Barnameh}, 1 and 15 November 2003). Accordingly, the price of flour sold to bakeries was raised from 40 rials to 100 rials in mid-2003. Despite such a radical increase in the price of flour, the price of bread was not allowed to increase by more than 17\% (\textit{Hamshahri}, 31 May 2003; \textit{Barnameh}, 1 November 2003).

Nevertheless, price increases became much larger than expected and inflation became a dominant economic issue in 2003 (\textit{Hamshahri}, 18 June 2003; \textit{Iran}, 25 April and 10 June 2003). In July 2003, Ayatollah Khamenie intervened directly and prohibited the planned price increases (\textit{Hamshahri}, 13 June 2003). Soon after that, the parliament passed a bill forbidding any price increases of the subsidized goods during the Third Development Plan (\textit{Hamshahri}, 21 July 2003). All price increases were rescinded. The price of flour was reduced to 40 rials per kilo and the government decided to repay the price difference to the bakeries that had bought flour at 100 rials per kilo (\textit{Hamshahri}, 23 August 2003).

There is little doubt that political considerations forced the government to retreat from its plan. Prices of all subsidized goods increased simultaneously, which aggravated inflation and caused public resentment (\textit{Barnameh}, 15 November 2003; \textit{Iran}, 6 May 2004). This was not expected by the policymakers who presumed that the price increases would be too small to cause any trouble (\textit{Barnameh}, 24 April 2004).

An additional problem was the timing of the price increases. In early 2003, the country was preparing itself for a parliamentary election. Price increases were magnified by the opposition to discredit the government and its supporting forces (\textit{Hamshahri}, 17, 18 and 19 June 2003; \textit{Iran}, 22 June and 23 July 2003). Official statements, interviews, and speeches witness that the government was under heavy political pressure before the price increases were stopped (\textit{Hamshahri}, 12 and 17 June 2003; \textit{Iran}, 15 June 2003 and 16 May 2004). Subsequently, the authorities made considerable efforts to ensure that the prices of subsidized goods, and especially bread, would be kept at their earlier level after the new law had been implemented (\textit{Hamshahri}, 14 and 23 August 2003).

\textbf{Concluding remarks}

The Iranian case discussed here clearly illustrates a dilemma that may face policymakers as a result of promises and commitments. Achieving self-sufficiency in wheat and pro-

\(^{13}\) For some examples, see \textit{Hamshahri} (12 July 1997; 5 December 2000; 5 January 2002; 11 December 2002; and 30 August 2003) and \textit{Iran} (16 June 2003).
viding cheap bread have evolved into important national goals in Iran and abandoning any of these goals may harm the legitimacy of the regime and the political stability of the country. At the same time, the policies employed to achieve the goals make them contradictory. The cheap-bread system led to a rapid growth in per capita consumption and wastes of wheat. As a result, demand has continued to surpass domestic supply, which performed comparatively well during this period. The policy has also implied high and unnecessary costs in the country. Although this has been acknowledged by the government since the early 1990s, it has hesitated to take the proper reforms, mainly for political considerations.

More recent political and economic developments make it difficult to expect any radical changes in the near future. First of all, the political scene has changed in Iran since 2004. A new parliament and a new president have been elected. The new majority in the parliament and the new government have repeatedly declared that they intend to seriously help the poor, promote socio-economic justice and control inflation. Moreover, oil revenues have lately been increasing very rapidly, especially since 2004. This would increase the expectations of the new administration which has promised to use the oil money to help the people. Finally, in 2004, it was announced that the country had attained self-sufficiency in wheat and the success was celebrated (Iran Daily 17 November 2004). It is then not easy to argue for controlling the consumption of wheat to reduce the country’s reliance on its import.

Nevertheless, subsidy reforms are not completely forgotten. Reform ambitions of the Third Development plan are duplicated in the Fourth Development Plan, 2005–2009 (Management and Planning Organization, 2005). Members of parliament and the cabinet also point out the need to reform the subsidy system. The question is still how to carry out such a reform to limit its potential social and political costs (Hamshahri, 22 September 2004; Shargh, 25 February 2006).

References


14 See, for example, Iran (29 May 2004, 7 and 9 August 2005, and 5 April 2006).

15 The average price of Iranian oil increased from about $27 to $36 between 2003 and 2004, which increased the annual oil revenues from about $27 billion to almost 37 billion (BMI, 2005). The revenues must have increased drastically considering the surge of the oil price since 2004.

16 ‘Putting the oil money on people’s tables’ is widely cited as one of the campaign promises of the new president during the election. However, the president has recently told the reporters that this was not his promise but was attributed to him by Shargh and he chose not to deny it at that time (Shargh, 25 April 2006).

17 There are reports that Iran started to import wheat again in 2006. Yet, government officials insist that the country is still self-sufficient and the wheat is imported simply for stock balances or only for animal feed (Hamshahri, 23 May 2006; Iran, 16 March 2006; Iran Daily 13 May 2006). See further Iran (24 April 2004) and Shargh (16 November 2004).

18 It should be mentioned that the Plan was passed just before the new government took over.


SCI, (Statistical Centre of Iran), Statistical Yearbook. SCI, Tehran (in Persian).


Shargh, an Iranian newspaper.


