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Simulating the effect of eliminating subsidy on gasoline consumption in Iran: Finding the optimal point

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Abstract

As do other oil-exporting countries, Iran allocates subsidies to her domestic use of gasoline. The subsidy amount, however, is comparatively high. The resulting low price spurs indiscriminate fuel consumption and reduces Iran's income from crude oil. The significant impact motivates this paper's analysis of the effects eliminated subsidy may have on the demand for gasoline. Two scenarios were simulated. A relevant demand function was estimated. Conclusions for sudden removal of gasoline subsidies predict a downward shift in the demand for gasoline, although it will always remain upward sloping. When the subsidies were gradually removed between1994 and 2004, gasoline consumption dropped, and then steadied after 2001. Beginning 2004, demand for gasoline rose towards its future real value.

Keywords: *Subsidy removal; gasoline demand; gasoline price*