



# Energy Dual Pricing in Iran and its Impact on Accession to the World Trade Organization

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## ABSTRACT

Energy has always been one of the most controversial issues in the World Trade Organization (WTO). The significance and sensitivity of energy was doubled when the major energy-producing countries/states sought to join the WTO. To join the WTO, many energy-producing and energy-exporting states inevitably needed to modify and change their own laws. The adoption of a dual pricing policy by the applying countries appears as one of the controversial issues in this regard. The same has led to the emergence of some disputes between the energy-exporting and energy-importing countries. From the perspective of some energy-importing countries, such behaviors are seen as subsidies, which are contrary to the basic principles of the General Agreement on Tariffs and Trade (GATT) implying non-discrimination, the principle of the most favored nations, and the national conduct. On the other hand, the Islamic Republic of Iran, as one of the largest energy-rich states, has been seeking to join the WTO. Iran subsidizes its domestic producers to support its energy sector and infant industries. This work focused on examining the pricing policies, and in particular, the approach to determining the price of energy in Iran. In addition, we studied the impact of the pricing method of the energy sector in Iran on the process of its accession to the WTO by a comparative evaluation of the accession process of the energy-producing countries such as Russia and Saudi Arabia acceding to the WTO. Through studying the laws and regulations of the energy sector of Iran, one can realize that Iran has been distancing itself from dual pricing in recent years, that it is striving to shift the price of its energy to the global price by benefiting from the experiences of the performance of the member countries of the WTO, and that it has aimed at accelerating the process of its accession to the WTO. JEL Classification: K19, K33, K42

## 1. Introduction

Pricing has turned into a strategic issue in today's economy and trade. Natural and legal persons, including governments, national business enterprises, and some international economic organizations are concerned about the issue of pricing and the need to take into account the process of pricing and any

relevant modifications and changes according to their micro and macro goals. The price element and the correct decision-making about it can adjust the flow of liquidity, lead to the satisfaction of customers and the distribution network agents, change the financial variables optimally, and, ultimately, assist the natural and legal persons in implementing their

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international financial obligations more efficiently.

The problem of dual pricing is one of the issues which has led to many controversies in the global markets in recent years. It should be noted that some countries arbitrarily reduce the prices of products and services in their own domestic markets with the aim of increasing the competitiveness of domestic producers, promoting the level of development, and gaining more share in the global markets. Hence, they somehow disturb the process of free trade and healthy and fair competition by intervening in the pricing process.

Most controversies and disputes on dual-pricing policies arise from the trade of energy and raw materials. Most energy-importing countries believe that the policies adopted by the energy-rich and exporter countries on how to determine the price of energy in general, and on resorting to dual pricing in particular, damage their interests and disrupt the order of the free trade. Thus, the countries in the first group sought to resolve the barriers caused by dual pricing policies through international institutions such as the WTO.

In fact, none of the major energy exporting countries was among the main and initial states which signed the General Agreement on Tariffs and Trade (GATT) (Marhold, 2013:2). Due to the same reason, the energy related topics were not specifically discussed at the time of drafting GATT (Marceau, 2012:385). However, since the beginning of business systems, energy has been covered more or less in multilateral trade agreements. The Havana Charter, as one of the first international commercial documents, has extensively set and concluded agreements on international merchandise trade such as agreements on the control of the production rules, on the quantitative control of export and import of primary commodities, and on setting the prices. In addition, the Havana Charter has always emphasized the role of natural resources in the economic development of societies (Leal-Arcas & Abu Gosh 2014:120). Nonetheless, it should be noted that the mentioned rules have never reflected in the General Agreement on Tariffs and Trade (GAAT).

During the multilateral trade talks in Tokyo and Uruguay rounds the energy-importing countries tried to determine some energy export limiting procedures (Selivanova, 2007:6). Unfortunately, no agreement was concluded on the energy policies among the members. The WTO agreements did not also provide any specific rules for the energy trade (Selivanova, 2010:1). Thus, the overall and general rules on international merchandise trade are still implemented and applied to the energy trade despite of the failed efforts of governments in the last two decades to negotiate for resolving ambiguities in energy issues. However, the debatable point is that the mentioned general rules do not include many of the problems the energy trade faces such as the dual pricing problem.

The issues on energy trade were heavily debated in the

WTO simultaneously with the accession of the major energy producing countries to the WTO. Many issues in relation to energy were raised in the negotiations over the largest energy exporting countries such as Saudi Arabia, Russia, Azerbaijan, Kazakhstan, Algeria, etc. joining the WTO (Leal-Arcas & Abu Gosh 2014:130). As estimated, the share of the energy products of these countries in the global trade is about 50% (Farhaan, 2018:18). Most of the energy-rich countries were requested by other members to change and reform their energy sector policies and laws at the time of accession. Some applicants for joining the WTO modified and changed their laws. A group of other applicants also believed that the request of the member states suggesting the modification and amendment of their laws is beyond the standards of the WTO Statute. In other words, these governments insisted that the request from the member states contained some kind of extra-contractual obligations, so they emphasized their position. Mexico, Saudi Arabia, and Russia were among the countries who opposed the reform of their laws at the time of accession to the WTO (Farhaan, 2018:19). According to some members of the WTO, such as the United States, the above mentioned countries used the dual pricing and preferential pricing for natural resources in their own domestic markets to boost their business power and excel their position against other countries deprived of natural resources (Ibid).

Another point to be noted is that, on the one hand, the energy sources are not distributed uniformly throughout the world (FAO, 2000:1); on the other hand, energy is considered to be an essential element in the national economy of all countries (Farhaan, 2018:198). Therefore, the energy policies of the energy-rich countries also affect the importing countries. At present, the high oil prices have caused the network of energy importing countries to fear the unbalanced supply of energy, which is a crucial and vital element in the economic growth. In contrast, the exporting countries see their interests in keeping the energy prices high. These countries prefer to meet the interests of their domestic industries, so they determine the prices of forms of energy much lower than the global level for domestic uses. Such factors could also act as other causes of the dual pricing of energy (Ibid).

These different viewpoints have led the energy importing countries to follow their differences and disagreements through the WTO. In fact, these countries ask the WTO to oblige the energy-rich countries to comply with the rules of healthy competition and eliminate the discriminatory policies based on its fundamental principles such as the principle of the most favored nation, the principle of national conduct, and the principle of free trade.

The Islamic Republic of Iran is also seen as one of the largest energy-rich countries with a great importance in the energy market (EIA, 2018:1). Iran has been waiting for over



twenty years to join the WTO (WTO, 2019). Since Iran also uses a dual pricing policy in some parts of its energy pricing, we wonder how much it will be obliged to modify the rules and regulations of its energy trade upon joining the WTO.

This research sought to answer the following questions:

- How legitimate are the arguments of the exporting countries in the WTO regarding the contradiction of dual pricing policy with the principles and regulations of the World Trade Organization?
- Have been the reform of the energy sector laws of countries such as Russia and Saudi Arabia to join the WTO based on the statutory requirements of the World Trade Organization?
- if Iran joins the WTO, will it also be obliged to modify its domestic laws?

To this end, in the first section, we reviewed the pricing, pricing strategies, and their importance in national and international markets. In the second section, we examined the dual pricing from the perspective of the WTO and discussed the agreements of this organization. In the third part, we scrutinized the dual pricing in the field of energy and its trade. Also, given the state of Iran's accession to the WTO on the one hand, and its strategic position in the global energy market, on the other hand, we described the energy pricing policies in Iran and the impact of such behaviors on its membership process of accession to the WTO in detail.

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## 2. Section I: Pricing in Iran

As mentioned above, price is regarded as one of the main factors in creating incentives for economic activities, and the pricing or prices control policies appear to be among the interesting and challenging topics and issues in the economies of developing and developed countries.

Pricing goods and services in Iran, always, and especially after the end of the imposed war and the development of five-year economic, social, and cultural development plans, has been a controversial and challenging issue. The situation of Iran, as a developing country damaged by several events such as the revolution, the war, and the sanctions, requires that the government partly interferes in the financial and economic system and the pricing of goods and services, at least in the necessary and required sectors. In this section, we examined the pricing process in Iran, in general, and the approach to the pricing of energy, in particular.

### 2.1. Pricing mechanism

The pricing of goods and services by the Organization for Consumers and Producers Protection dates back to 1981. The general assembly of this organization, according to a statute approved by the Revolutionary Council, is the supreme

official pricing reference. The representatives of the general assembly work under the title of the Prices Determination and Stabilization Board, which is one of the pillars of the Organization for Consumers and Producers Protection.

In 1981, a list of items subject to pricing was approved by the general assembly of the organization, and the final approval of the prices of essential and necessary commodities was added to the responsibility scope of the Economic Council; however, the approval of the prices of the items not considered essential by the general public was assigned to the Prices Determination and Stabilization Board (Saghafi, 1998:22). During the imposed war, due to the expectation of people from the government and the problems existed in the country, many items of goods and services were included in the pricing process, which continued until 1989. Since 1989, with the beginning of the first economic program, the number of items subject to pricing was gradually diminished, and the gradual elimination process of the pricing of these items started (Saghafi, 1998:22). Hence, by 1994, the number of pricing items was few; nevertheless, with rising inflation in the Iranian market, the government decided to again use pricing mechanism for the essential items. In fact, in a situation where the economy is severely inflated, the government has no choice other than determining the prices of commodities such as bread, local currency, and gold so as to prevent the economy from being trapped in the shocks and severe fluctuations, which ultimately lead to an economic collapse (Dini, 1998:38).

The Iranian government, according to its conditions, inevitably has to distance itself from using the method of determining the price of goods and services based on the natural system of supply and demand and needs to intervene in the pricing process by two direct and indirect methods.

In the first method, the government either determines the price of the goods, defines the prices based on the costs of the production factors, and dictates to the firms to sell the goods at the pre-determined prices, or, in conjunction with the manufacturers and producers, does the pricing, which is known as the guaranteed purchase.

Through guaranteed purchase, the government helps the producers increase their profit margins, and usually the price determined by the government is higher than the price that the manufacturers can sell their product in free terms. In this case, the sellers do not have to sell merely to the government and can sell their goods to any buyers. For example, the use of this method is common in the case of agricultural products. It should be noted that in order to protect the agricultural producers who sell their products to the government at a guaranteed price and to prevent their losses due to the late payment of the purchased products, the amendment to Note (3) of the Law on the Guaranteed Purchase of Agricultural

Products and the addition of two other notes to it were approved and communicated in September 2004.

In Note (1) of the single Article of the Iranian Act of Guaranteed Purchase of Basic Agricultural Products, the Ministry of Agriculture is obliged to determine the guaranteed purchase prices of the basic and essential products by observing the actual production costs in a conventional utilization unit through maintaining the relationship of trade within and outside the agricultural sector every year and propose to the government. Meanwhile, in the same Article, the government is required to declare the minimum guaranteed purchase price and to make purchases through the relevant units (The Iranian Act of Guaranteed Purchase of Basic Agricultural Products, 1989).

In the indirect method, the government inspects the prices through monetary, financial, and income policies (Dini, 1998:39). This method is more appropriate than the first one. The monetary and financial policies related to the budget debate can change the economic structure of a country optimally so that the supply of the goods the government seeks to reduce the prices of which will increase in the long term and vice versa. In this case, the prices of goods will decrease as the supply increases, and the need for subsidies will be eliminated. Further, by reducing the supply and the rise in prices, the goods to which, in the perspective of the government, lower resources should be allocated will be produced to a lesser extent (Dini, 1998:39).

Although the government's policies in recent years, which follow a pattern to transfer the pricing of goods to the market, have aimed at further flourishing the economic system, the economic structure of Iran is such as to make it difficult to achieve such a goal and to allow the market forces to move in this direction easily. For example, in the agricultural sector, in addition to the failure of pricing policies, we also face the contradictions between the monetary and fiscal policies of the state.

Regarding the insufficiency of pricing policies, we must admit that, in the inflationary conditions of Iran's market, when only some of the goods are included in the pricing process and the rest of the goods can adjust their prices in accordance with the inflation rate, the goods in the first class, which are generally in the category of the basic goods, will tolerate pressure by different aspects of supply and demand. From the aspect of supply, as the production of excluded products is more profitable, producers tend to stop the production of the included products or not to sell it to the government as much as possible. Therefore, the tendency towards production will be weakened. In terms of demand, since the prices of the covered products are relatively stable and their consumption is less expensive for people, the consumers facing rising prices will be more likely to consume the covered goods so as to

reduce their costs (Mehrabanian, 2009:27).

Regarding the contradiction between the pricing policy of the state and other monetary and financial policies of the country, it should be mentioned that the government has always increased the amount of money in circulation in recent years and in conditions of the absence of or low demand for domestic production. In this context, on the one hand, the government has increased the demand rate with its monetary policy; on the other hand, it has tried to prevent the rise in the price of some commodities, which is rooted in the pressure of the same created demand (Mehrabanian, *ibid*).

Therefore, in order to boost the economic growth, increase the employment, and control the level of prices, Iran's government needs to establish a balance between pricing policies and some macro-policies such as monetary policies, trade policies, and anti-inflationary methods. The government should also pay attention to the nature of different products and markets in the process of pricing and should predict and consider the guarantee of effective implementation of pricing policies.

## **2.2. Energy pricing**

The energy pricing trend in the price index of the factors in the production of the Iranian economy is not aligned with many industrial countries and even the energy exporter states. Exercising governmental supporting prices in the energy market has led the energy to replace other primary production inputs, namely labor and capital. Applying supportive prices by subsidizing the energy sector has been done with the aim of boosting economic growth, controlling the level of prices, strengthening the development, and creating jobs. However, we should check out whether the mentioned goals have been met by the policies adopted by Iran's government in the energy pricing or not. In this section, we studied the energy pricing policies and the impact of these policies on the realization of Iran's development goals.

Within one year of second world war's end, energy markets underwent various changes in the industrialized and developing countries. Due to benefiting from the modern technologies, the industrialized countries pursued the process of production relying on inexpensive forms of energy, while developing and even oil-rich countries focused on the user technologies due to having competitive work force and labor (Bastannejad and Nili, 2005:202).

After the oil shock in the 1970s, the countries with low-price energy resources turned to the energy-consuming technologies, while the industrialized energy importing countries sought to utilize the capital-needed and energy-reserving technologies. On the other hand, by increasing the opportunity-cost of energy resources in the global markets and the emergence of topics on environmental issues, energy



consumption, and constraints on the fiscal and tariff policies of the states regarding the free trade, the necessity to moderate the relative prices of forms of energy became inevitable in the developing countries as well as energy exporters. Thus, many energy-exporting countries like Saudi Arabia, Nigeria, and the UAE revised the policy of inexpensive energy supply, and only a few countries such as Iran, Libya, and Algeria insisted on implementing their previous policy.

Over the past four decades, the process of support for prices has been intensifying in the energy sector in Iran's economy, and the government has boosted the process of generating competitive advantage and the growth of its intensity by increasing the provision of subsidies to the energy sector. In fact, in the Iranian economy, through imposing the price ceiling in the market of forms of energy, the government has continuously pursued the policy of creating the price advantage. For example, in the case of electricity, the Ministry of Energy has never been able to receive the real cost of electricity from consumers, and even the electricity tariffs are free for some subscribers (users) in accordance with the law. Thus, the electricity provided to customers is the most affordable type of electricity among 200 countries around the world. The price of electricity without taking into account the cost of fuel consumed at a power plant is about 1050 Iranian Rials per kilowatt hour, while the average selling price of electricity is 660 Iranian Rials. It is also worth noting that the price of electricity falls to 170 Iranian Rials in the warm regions of Iran and in the agricultural sector. Given the fact that the Ministry of Energy provides around 240 billion kilowatt hours of electricity for consumers over a year, a figure of about 100 trillion Iranian Rials per year is the difference between the finished price and the obliged sale price of electricity ([www.eghtesadonline.com](http://www.eghtesadonline.com):2018).

The government has been subsidizing production inputs in general and the forms of energy in particular to pursue the goals of strengthening the flow of economic growth, increasing employment, controlling the general level of prices, and, ultimately, establishing social justice (Bastannejad and Nili, 2005:208). In this regard, the policymaker expects that the increased paid subsidies will improve the indices of employment rate, long-term economic growth, and the inflation rates. However, based on economic models in Iran, reducing the relative prices of forms of energy has had a reverse effect and led to an increase in the inflation rate and the intensity of energy consumption. In other words, energy subsidy inversely relates to economic growth, and the increase in the mentioned subsidy has limited the production gap and the GDP growth through fiscal deficits and inflation (Bastannejad and Nili, 2005:215).

Therefore, the Iranian government needs to change a majority of the major variables related to energy pricing so

that the impact of subsidies paid to the energy sector can be evaluated separately to study and examine their positive and negative effects using the economic models.

It is also necessary to modify the energy prices. Usually, the energy-price adjustment policies have focused on general price modification and have proposed global rates. To be effective and efficient, such reforms must be accompanied by social considerations and consider the situation and benefits of the low-income groups.

On the other hand, it should be noted that although the low-price energy as well as the low-wage labor play a significant role in keeping the production costs low, and the manufactured products can compete in the global markets, what the economic policy-makers should consider is the real relative advantage but not the relative advantage created artificially with an unrealistic support of the industries since the great price difference between the domestic energy and energy in the neighboring countries leads to illegal trade and smuggling of energy (Mazraati, 2001:18).

The government should determine the price of energy with regard to the equilibrium exchange rate (free market) and prices in the international markets. In this case, the import and export of energy will be allowed, and the private sector can enter the energy market with confidence. At this stage, the government can also play the role of monitoring and guiding the energy sector through the imposition of taxes and tariffs, and thus eliminate the effects of global market price fluctuations on the national economy. Fortunately, the legislator has required the government to increase and adjust the prices of forms of energy relative to their prime costs by passing various laws such as the subsidy purposefulness law, the law of the fifth and sixth development plans, and the law of protecting the nation's industries. However, we should consider that, due to the fluctuations in oil prices, the government has always faced difficulties in paying for the difference in energy prices.

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### 3. Section II: Energy Dual Pricing and Accession to the WTO

Iran is one of the countries with the richest sources of energy and has always been seen as one of the largest exporters of oil and gas; hence, Iran has a special place in the international markets. However, Iran has not yet succeeded in joining the WTO to use the capacities of this organization for stabilizing and improving its position in the global energy market. One of the obstacles Iran faces to join the WTO is granting subsidies to the energy sector and the government's involvement in pricing and adopting energy dual pricing policies. Despite the fact that the use of dual pricing policy has not been explicitly opposed by the WTO, some energy-rich countries had to stop

this policy to be able to join this organization, yet we should wait to find out whether Iran continues to use this method to determine its energy price or not and to what extent this pricing method will appear to be an obstacle to joining the WTO.

In this section, we explored and studied the status of Iran's accession to the WTO, the energy dual pricing policy, and the challenges the energy sector encounters for accession to the WTO. In addition, we reviewed the laws and rules of energy pricing in Iran and the impact of its joining to the WTO through the study of the procedure for other energy-rich member states.

### **3.1. The state of Iran's accession to the WTO**

Since the establishment of the WTO and its predecessor, GAAT, 164 countries have already joined this entity. We can realize the importance of the role of this organization by considering the fact that now more than 95% of the world's goods and services trade occurs within the framework of its laws and regulations, which has profoundly increased the significance of the issue of Iran's accession to the WTO for this country.

Iran submitted its membership application to the Secretariat of the WTO in 1996 and was accepted as an observer member of the WTO in May 2005. On October 28, 2009, Iran's trade regime was approved by the Council of Ministers to be presented to the WTO and subsequently submitted to the secretariat of this organization for consideration. Initial studies by the WTO led to raising 700 questions about Iran's commercial regime. The Ministry of Commerce prepared the answers to these questions in collaboration with governmental agencies and relevant institutions (around more than 50 institutions) and presented them to the WTO in November 2011 (Jahandideh, 2009:1).

The process of Iran's accession to the WTO has been stopped since 2011 so far. One of the main reasons for the cessation of the process of Iran's accession to the WTO was the simultaneity of the submission of the package of Iran's commercial responses with sanctions by the United States and its allies (www.eghtesadnews.com:2018). Hence, it did not seem reasonable that the countries working together to impose all-around trade sanctions against Iran would meet and negotiate with Iran in the WTO on the trade facilitation.

In fact, if we examine the history of Iran's accession to the WTO, we will conclude that of the 23-year history of Iran's membership request, we have been responsible for about 3 years of delay in submitting the trade regime report to the WTO. In the next years, when Iran had a strong determination to join the World Trade Organization, the accession of Iran has not been realized due to the lack of consensus on the subject in the WTO, which is rooted in political issues. Thus, despite the agreements made with the Head of the Working Group on the

Accession of Iran, the United States prevents the appointment of the Chairman of the Working Group in the agenda of the General Council of the WTO while this process takes only a few months for other countries. For example, Afghanistan requested membership in the WTO in 2003, and the working group for the membership process of this country was formed in 2004. It is also worth noting that Afghanistan became a full member of the WTO on July 29, 2016, and hence was the last country which joined this institution (www.wto.org:2019).

With all the difficulties Iran faces in joining the WTO, we should not forget that joining the WTO is indispensable since almost all the global trade is in the hands of the members of the WTO and subject to its rules and regulations, and the members of this organization are not willing to have commercial relationships with the non-member countries at a level lower than these rules and regulations. The free trade between countries has led to increased competition, and such an increase in competition will be associated with innovation and better use of production factors. The competition atmosphere leads the businesses and trade into innovation, improvement of processes, creation of new technologies, and, in general, the advancement of science (Jahandideh, 2009:3).

With Iran accession to the WTO and complying with its rules and regulations, the producers and exporters of Iran will gain a better position for export; however, they will have to promote and improve the quality and quantity of their products to achieve a higher share in the markets of other countries (Jahandideh, 2009:5). The efforts to more extensively enter the global markets can lead to the promotion of technology, improvement of processes, and possible discovery of new relative advantages. As much as our share of the markets in other countries increases, it will become easier for us to fairly achieve the economic growth and development of our country.

### **3.2. The Legal effects of Iran's accession to the WTO in the energy sector**

Given that Iran is on the path to accession to the WTO, some of Iran's laws and regulations on subsidies and pricing in the energy sector are likely to change. Hence, in this section, we explored the laws and rules of the five-year plan of economic, social, and cultural development, the prior budget laws, the law of targeted subsidy plan, and other energy related laws to assess their compliance with the WTO laws and regulations.

#### **3.2.1. The laws on the five-year economic, cultural, and social development plan**

The economic, social, cultural, and social development plans of the Islamic Republic of Iran refer to the "Five-year Plans" which are drafted by the government in power and passed by the parliament. Since 1989, six development plans



have been approved, ratified, and implemented. In this section, the energy pricing sections were discussed considering the above laws.

The law on the first five-year economic, cultural, and social development plan of Iran dates back to 1989. The main objectives of the first plan include, but are not limited to, the following:

- Creating economic growth in order to increase per capita production, generating productive employment, and reducing economic dependency by emphasizing the self-sufficiency of agricultural strategic products and curbing the inflation;
- Providing the basic needs of the people;
- Determining and modifying the consumption patterns to specify the needs of humans and society in the course of material and spiritual growth and evolution by preserving human dignity and liberty;
- Organizing the spatial and geographic distribution of population and activities tailored to the relative advantages of each region with the exception of political and military considerations.

The topic of energy has been sporadically mentioned in the first plan of economic development. For example, in determining the overall country's policy, in paragraphs 2-4, the growth of capital and intermediary goods of the economy particularly agricultural inputs, water and soil, mineral and heavy industries, goods needed by the society community, energy provision, communication, development, research and technology aiming at replacing the imports are emphasized while giving priority to the maximum use of the available capacities.

Paragraphs 43, 44, and 45, respectively, have also referred to the following:

- Prioritizing the provision of gas for gas injection projects in order to prevent the crude oil loss and strongly avoid the recovery of gas cap of the oil reservoirs;
- Exploring and extracting gas from the reservoirs shared with neighboring countries, replacing the most amount of petroleum products and other energy-producing fuels with natural gas, and distributing gas respectively for the uses of power plants, industries, commercial and household purposes with the priority given to the country's high-consumption regions, cold regions, and nearby areas.

In addition, Sections 48 and 49 of Part 4 have also addressed the improvement in the utilization of the country's power industry facilities through the following measures:

- By increasing the utilization factor, load factor, and thermal efficiency of power plants and reducing energy losses in transmission and distribution networks;
- Policy making in the field of efficient use of energy and savings in fuel and energy by Ministries of Energy and Petroleum;

- Strictly observing the priorities of the energy sector (electricity, oil, and gas) by the Ministry of Industry and Commerce regarding the means and equipment of the energy consumers.

Regarding energy pricing, the main goal of the first development plan of Iran was to achieve the real prices by considering the livelihood conditions of low-income classes and observing the fair and justice. In order to support production and export, Paragraph 42 of Part 4 states that the pricing method of manufactured, imported, and exported products should be revised.

Also, Paragraph 5 of the general policies has referred to making changes in the policy of pricing commodity and services to gradually create equilibrium prices for the economic resources. According to Clause 5-1, the general principle in the case of public goods and services such as water, electricity, gas, liquid gas, kerosene, gasoline, gas oil, fuel oil, motor oil, telecommunications, and post is to move towards gradually providing the acceptable costs of the new and current capitals of the companies which manufacture/provide these goods and/or services.

Despite the fact that the first development plan was set to reform the energy price structure, the post-war critical situation, the incidence of inflation, and the necessity to provide the minimum conditions for people's lives did not allow the realization of the first development plan objectives.

The second development plan covering a 4-year period between 1995 and 1999 has also addressed the issues of saving in energy consumption, improving the production and consumption policies, and increasing the utilization of energy resources in several notes. A single article of the development plan in Paragraph (b), Note 16, refers to the price of energy. According to the aforementioned note, in order to save on the consumption of oil products and to insure social justice, the prices of oil products should increase during the second plan, and the resulting effects have to be adequately offset. Paragraph (c) of the same note states that the increase in the price of water, gas, and electricity is subject to the increased consumption, so the rate of payment remains constant for the low-consumption customers, while it rises exponentially for the high-consumption subscribers.

In Note 21 of the single article of the second plan, in order to organize the pricing to allow monitoring and control, clarify the subsidies, and improve the competitiveness of domestic products compared with imported products, it was decided to cut all discounts, preferences, exemptions of customs duties, and commercial profits of companies such as National Iranian Gas Company, National Iranian Oil Company and affiliated companies, and National Iranian Petrochemical Company and its subsidiaries.

The third part of the single article of the second plan,

which describes the government revenue policies, indicates that the tax exemptions granted to different sectors, field-activities, and institutions through price modifications, budget allocations, and reviewing the tax system based on the definition of income base should gradually be eliminated with the exception of the agricultural sector and its complementary industries.

In the eighth part, dedicated to pricing, although the correction of prices has been targeted, Paragraph 9 has addressed the coordination in support of producers, consumers, and exporters. The tasks of setting, coordinating, and controlling the prices are assigned to the Council of Economics. It is not clear, however, that how the support and protection of the producers, exporters, and consumers will be realized in the process of pricing.

The law on the third development plan was approved in April 2000 and was in force until 2004. Chapters 5, 7, and 15 of the law on this plan have covered the issues of subsidies, tax system and budget, and the energy respectively.

Article 33 of the third plan states that the policy-making and planning in the field of exploration, extraction, and production of crude oil and the refining of petroleum products and its main and minor products are in the state monopoly, and the government has the authority and is allowed to, within the framework of this law as well as the regulations which are prepared and issued by the Ministry of Oil within six months and will be approved by the Cabinet of Ministers, assign the implementation of activities related to the operations of refining, distribution, and transportation of petroleum products and its main and secondary products to the natural and legal persons in such a way that does not create monopoly in the nongovernmental sector and will not deprive the government authority of the sovereign affairs guarantee and the continuity of the provision of services. However, Paragraph (d) of Article 120 states that the government is obliged to set a bill and submit it to the Islamic Consultative Assembly for approval in order to modify and improve the structure of state-owned companies affiliated with the Ministries of Oil and Power in line with the implementation of the policy of reducing the state ownership and tenure and increasing the economic-technical efficiency of these companies by considering the royalty interest of oil and gas consumed domestically as the national capital during the first year of the third plan.

The list of the essential goods eligible for the subsidy provided in Paragraph (a), Article 46, of the third plan does not include energy. Nevertheless, Article 47 provides subsidies for agricultural inputs such as fertilizers and poisons; perhaps, this type of subsidy can be justified in the form of latent subsidy of the energy sector.

Article 52 also aims to support the production sector by proportioning the costs of electricity and gas and providing

preferential rates.

Although one of the objectives of the third plan is to reduce the involvement and tenure of the government, Paragraph (d) of Article 121 has explicitly addressed the pricing of oil, gas, and electricity by the government, and Paragraph (c) of Article 122, determines the guaranteed price of power and electricity sector, which is considered to be a kind of subsidy.

The Law on the fourth five-year economic, cultural, and social development plan, approved for 2005 to 2009, approximately coincide with the regulating and formulating the targeted subsidy plan. According to Article 3 of the law of the fourth plan, the pricing of fuel oil, oil gas, and gasoline should be made based on the wholesale prices of the Persian Gulf. Furthermore, the price of natural gas was supposed to be set based on its lowest level price in the neighboring countries, and the kerosene and liquid gas would be supplied based on the subsidy-free prices for commercial and industrial uses. Under Article 22 of the aforementioned law, the price of compressed natural gas is set at a maximum of 40% of the price of gasoline. Article 26 also specifies the pricing of electricity, gas, water, and some commodities. Moreover, Paragraph (c) of Article 39 of the law restricts the pricing to the public and exclusive goods and services and essential goods.

However, in 2004, an amendment was added to Article 3 of the law, according to which the prices for the sales of products such as gasoline, gas oil, kerosene, fuel oil, gas, other oil products, electricity, and water, as well as the prices for services such as sewage service, telephone communications, and post service were fixed for the first year of the plan at the price set at the end of September 2004. It was also decided that, for the next years of the plan, the changes in prices would be proposed to the Parliament in bills along with its socio-economic justification.

It is stated in Paragraph 4 of Article 21 of the fourth plan that, in order to create further value added and use gas resources in industrial and mineral development, the government is allowed to guarantee and provide up to 9 billion dollars to establish energy-consuming industries and industries with comparative advantages for export purposes complying with the ceilings approved by Article 13 of the Plan on the Settlement of Foreign Exchange Obligations of the country. In addition, Article 27 of the law of the fourth plan allows the government to provide preferential loans for the deprived areas for job-creation projects. The mentioned act is entitled to subsidize agricultural inputs such as fertilizers and poisons, allow the guaranteed purchase of agricultural crops, and provide low-cost electricity to the agricultural sector. It seems that the pricing policies of the act of the fourth plan are not in conflict with the WTO rules and are ultimately considered among the yellow-light or traceable subsidies.

The fifth development plan, which was approved for the



years 2011 to 2015, has dedicated separate sections to oil, gas, electricity, and the clean energies.

The sixth plan was also approved for the years 2017 to 2021. This plan has also dealt with energy, industry, and mining in some sections. In the fifth plan, the government is obligated to supply energy at its full price and somehow reduce its subsidy. On the other hand, the government is required to pay the difference in cash to the relevant institutions, like the Ministry of Energy. However, due to the fall in oil prices and the prevailing economic conditions, the government has failed to accomplish this line item in the budget and pay the difference in cash.

In the sixth plan, Paragraph 3 (b) of Article 39 states that in order to insure transparency in exercising the law, the government is required to submit the revenues and payments related to the targeted subsidies plan law in a separate table containing the following items along with the budget of the years to the Islamic Consultative Assembly:

- The total revenues from implementing the targeted subsidies plan;
- The related value added tax;
- The share of energy producing and energy distributing companies;
- The share of the Organization for Targeted Subsidies Plan in order to allocate cash and non-cash subsidies to the households and monetary helping to the health sector and support the production and employment through financing related to the implementation of the Law on the Modification of the Energy Consumption Model approved on 23 February, 2011 and the Law on Transportation Development and Fuel Consumption Management approved on September 12, 2007.

In the fifth and sixth plans, although the government is still involved in energy pricing and giving subsidies to this sector, the legislator emphasizes the finalized and full price of the energy and seeks to eliminate the gap between the domestic price and the global price.

It can be argued that the pricing policies of the law of fourth to sixth plans do not contradict the rules of the WTO and will eventually be regarded as traceable subsidies. However, despite the challenge of Saudi Arabia and Russia in joining the WTO regarding the energy dual prices, which have been considered by some hidden negotiating parties and the members to be removed, it is believed that Iran will face a serious challenge in this context. Nevertheless, it should be noted that Iran's energy sector subsidies are examples of general and permissible subsidies under the WTO regulations since they are paid horizontally to all sectors, and the condition for being specific and exclusive is excluded from it (Zare, 2009:94). However, as based on the provisions of Article 12 of the WTO agreement, the country applying for the accession to the WTO should join the organization in accordance with

the terms of the agreement between itself and the organization, and the current trend in energy pricing is unlikely at the time of accession and afterward.

### 3.2.2. The Targeted Subsidies Law (TSL)

Iran's economy is moving from centralized planning to decentralized planning, and energy subsidies are one of the most fundamental discussions of this transition period. The importance of this point is further highlighted when we realize that the revenues from the sale of various forms of energy constitute more than 90% of the national income; on the other hand, huge amounts of the national budget are allocated and spent annually under the title of subsidies for various forms of energy (Naji and Sotoudeh, 2014:46). Hence, the removal of subsidies is of particular importance.

The Iranian Targeted Subsidies Law (TSL) containing 16 Articles and 16 Notes was passed on January 5, 2010. The law aims to gradually eliminate subsidies and bring the price of energy closer to the finished and global price. According to Paragraph 1 of Article 1 of TSL, the domestic sale prices of gasoline, diesel fuel, fuel oil, kerosene, liquefied petroleum gas, and other oil derivatives in terms of the quality of carriers and costs (including shipping, distribution, tax, and legal fees) should not be less than 90% of free on board (FOB) price in the Persian Gulf by the end of fifth five-year development plan. Furthermore, based on note of this Article the sale price of crude oil and condensate to domestic refineries is determined to be 95% of the price of delivery in the Persian Gulf (FOB price), and the purchase price of the products is determined by the mentioned price. Based on Paragraph 3 of Article 1, the average domestic sale price of electricity should gradually be set to be equivalent to the finished price by the end of Iran's fifth five-year development plan. Nevertheless, according to Note 1 of Article 1, the government is still allowed to apply preferential prices to electricity and natural gas in terms of geographical areas.

Although the main goals of TSL include reforming the economic structure of Iran in low-cost fuel, reducing government interference in pricing, and making the prices transparent, adopting such a policy regarding subsidy does not match the government's interventionist policies in areas such as trade or monopoly conditions in some Iranian industries. For example, pricing or other interventions should be reduced in conditions where government intervention and imposition of high tariffs make people buy a domestic car with an average gasoline consumption rate twice as large as the global level ([www.ayaronline.ir](http://www.ayaronline.ir):2019).

In the TSL, there is no possibility of price discrimination and step-up pricing for some government goods and services such as electricity, gas, and gasoline given the smart fuel system which can identify each subscriber's consumption rate. In other words,

different prices can be obtained from different groups depending on their consumption. However, this initiative (using different and more efficient policies for energy carriers) is not explicitly stated in the case of energy carriers subject to the TSL, and a common decision has been made for all types of energy carriers. It should, however, be noted that Iran is still one of the largest subsidizing countries for fossil fuel in the world despite its efforts to eliminate energy subsidies in various steps, align the domestic energy prices with the global ones, and eliminate the dual pricing policy (www.old.alef.ir:2019). However, a study into the direct effects of the increased prices of energy carriers in various sectors shows that this increase should occur gradually, more gently, and uniformly, and this policy should be implemented simultaneously with a non-price policy (Naji & Sotoudeh, 2014:52), otherwise it may lead to the bankruptcy of industries or manufacturers' leaving the industry sector.

### **3.3. A Comparison of Energy Dual Pricing Policies of the WTO's Members**

It is well known that the exporting and energy-rich countries were not significantly present in the WTO until a few years ago, which led to the adoption of trade policies which sometimes harmed these countries and deprived them of the economic benefits of their energy resources. Concurrent with the membership request of the largest energy-rich countries such as Saudi Arabia, Oman, and Russia, the energy pricing policies of these countries were strongly opposed by the WTO members.

When Saudi Arabia acceded to the WTO in 2005, its policy on energy dual pricing was criticized by the energy importing countries. Therefore, Saudi Arabia faced intense pressure at the time of its accession to the WTO to undertake specific commitments on dual pricing and was ultimately forced to eliminate the dual price of natural gas liquid (WT/ACC/SAU/61,Para:26). Some members of the WTO have argued that the low price of natural gas liquid (NGL) causes Saudi producers to benefit from the subsidy, which raises concerns (Mathur, 2014:33). The Saudi Arabia counter-argued that the domestic sale price of NGLs was based on long-term contracts negotiated between producers and consumers and set in accordance with international market prices adjusted downwards for commercial and cost-based considerations. The domestic price of NGLs, while lower than the export price, insured the full recovery of production costs and a reasonable profit even after the downward adjustment. NGL prices for export markets reflected higher export costs on transportation, infrastructure, marketing, etc. The Saudi Arabia also provided assurances that NGLs were available on a non-discriminatory basis to all users in Saudi Arabia, whether Saudis or foreigners (Mathur & Mann, 2014:77). However, in Resolution No. 68 of the Saudi Council of Ministers on November 25, 1995,

the representatives of the government acknowledged national industries in Saudi Arabia using liquid gases (butane, propane, and natural gasoline) a 30% discount of the lowest international price obtained by the exporting country in any quarterly period from any overseas consumer (United States International Trade Commission,1999:16). A prototype of such preferential pricing is methyl tert-butyl ether (MTBE), which is produced from methanol. In an anti-dumping petition filed by the US producers of ethanol as a product competing with MTBE, it was claimed that the dual pricing system subsidized MTBE through low-cost provision of the raw material, i.e. natural gas and methanol, to refiners in Saudi Arabia; therefore, the US ethanol industry suffered material injury. The European Union had raised concerns that this practice was indirectly affecting the EU petrochemical industry. For this reason, dual pricing was discussed in the EU-Saudi Arabia bilateral market access negotiations. The negotiations, however, failed in August 2005; the EU surprisingly abandoned its efforts, and the agreement on Saudi Arabia's accession to the WTO was signed (Nedumpara, 2014:33).

Many experts believe that the Saudi Arabia actions do not violate the WTO subsidy agreement and compensatory actions of the WTO. Under the agreement on subsidies and countervailing measures, a measure can be considered a subsidized measure if a) financial assistance is provided by the government or government authorities in the territory of a member; b) it is followed by an advantage for the member; and c) it has a specific aspect. Moreover, in order to cope with the subsidies granted by a government, the subsidies must be among the prohibited or at least actionable subsidies. To this end, Appendix 1 to the agreement on subsidies and countervailing measures has necessitated three conditions in order for government assistance to its domestic customers to be considered specific and prohibited subsidies as follows:

- A government or its affiliated institutions should consider more favorable conditions for domestic goods or imported goods used in the manufacture and export of another product.
- Favorable conditions shall apply only to this product and shall not include goods which can compete with this product or similar products.
- Favorable conditions should create a benefit that results in discrimination provided that both domestic and imported goods are available without any restriction and the only criterion for preferring one over the other is commercial considerations such as lower price.

It should be noted, however, that the terms set out in the agreement and its annex only apply to exported goods and do not include goods produced for domestic use. Nevertheless, in Saudi Arabia, the costs the government receives for raw materials used in petrochemicals are less than those received for domestic consumption. The agreement also considers subsidies



to be prohibited when they are “specific,” while raw materials are provided at a lower price to all companies operating in the Saudi petrochemical sector rather than to a specific company or industry. According to Article 2 of the agreement on subsidies and countervailing measures, a subsidy shall not be considered a specific subsidy if it is provided to consumers regardless of their specific criteria and conditions. Another specific condition for subsidy is its allocation to a limited number of companies, the benefit of particular firms, or its unequal allocation to certain companies considering their variety of economic activities. The agreement on the rules of determining specific companies appears to be ambiguous and has created a clear restriction on the use of subsidies for this type of companies, which is because any particular industry uses its own primary resources, and thus granting any kind of subsidy to that industry may be considered “specific.” Special conditions such as proof of damage and serious harm to the industries of other countries are also needed for the actionability of Saudi domestic subsidies to domestic manufacturers. Proof of serious injury itself needs meticulous case-by-case evaluations (Mathur,2014:77). Therefore, it is difficult to prove that dual pricing in Saudi Arabia is considered a subsidy and violates the WTO agreement on subsidies and countervailing measures.

However, Saudi Arabia’s accession negotiations concerning dual pricing created two precedents for other WTO members. First, governments also have to consider the costs of energy products recycling, and, second, natural raw materials have to be made available to consumers in a non-discriminatory way regardless of their nationality so that it cannot be considered a subsidy.

After Saudi Arabia, the issue of dual energy pricing was raised again when the Russian Federal Government acceded to the WTO. The price of feedstock is determined by Russia at a level that could not be maintained if it was otherwise exposed to market forces. For example, in the case of Russia, the gas and electricity sectors are controlled by the state (WT/ACC/RUS/70) (WT/MIN (11)/20). Although these sectors are privatized, the majority of shares in energy companies such as Gazprom and RAO UES belong to the government. Prices for gas and electricity are set by Federal Tariff Service (FTS) and the Regional Energy Commission (REC). FTS is empowered to regulate the upper bounds for wholesale prices of electricity and gas (Nedumpara,2014:32). Several members of WTO raised concerns on dual pricing since Russia charges lower prices for natural gas devoted to domestic consumption than to export. According to reports, differentiated wholesale prices are set by the Russian Federal Agency, and this differentiation is controlled on the basis of numerous legislative and administrative acts (Ibid). It is further reinforced with a special export tax on gas exports which is implemented alongside. During Russia’s accession

negotiations, the European Union (EU) maintained its position that the domestic energy prices in Russia were much lower than the world prices, which prejudiced the EU producers. The EU also contended that the Russian government had a monopoly over the energy industries and that it imposed very high export taxes to support a domestic price of gas at a level below the market price. Russia, on the other hand, maintained that (a) this practice was not undertaken to support domestic markets and (b) that it is impossible for Russia to move to world energy prices in a single day (Belyi, 2012). Russia also stated that its energy pricing was not a subsidy as defined in the agreement on subsidies and countervailing measures (SCM) or any other provisions of other covered WTO agreements. Russia also relied upon a World Bank study that enlisted the merits of dual pricing of Russian natural gas. According to the World Bank study, Russia would lose an amount anywhere between 5 and 7 billion dollars per year if it were to eliminate this practice and unify the price of feedstock (Nedumpara, 2014:33). However, Russia undertook to reform its gas pricing laws and develop market pricing principles so that there would be the same price of gas in the domestic and global markets.

Dual pricing was also discussed when Oman acceded to the WTO (WT/ACC/OMN/26, Para: 22-23). Despite being an energy major, the government set maximum prices for petroleum and electricity. Prices for petroleum were set above world market price levels, while electricity was subsidized. Local petroleum prices had been increased for “fiscal reasons” and “to encourage more rational use of petroleum products.” Electricity tariffs were differentiated for “social reasons” and “to encourage the development of infant industries” (Mathur & Mann, 2014:78). However, Oman confirmed that it would eliminate the prohibition on importation of petroleum products upon accession (WT/ACC/OMN/26, Para: 52 & 57).

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#### 4. Conclusions

Price is one of the key elements in economics and commercial activities, and pricing and price control policies are among the topics of interest in developed and developing countries. In other words, pricing is one of the most important tools of development for any country.

The government’s intervention in pricing as a policy to support the domestic market, gain greater share in international trade, and support its producers and consumers had both positive and negative effects. Some economists believe that this intervention is an appropriate policy in most developing countries where domestic manufacturers are unable to compete with foreign ones and cannot gain profit in world markets. In addition, the domestic economy of such countries generally suffers from inflationary conditions, and ordinary

people do not have the purchasing power. Therefore, the government needs to support the low-income groups through its intervention in pricing. Some others argue that government intervention in the pricing of goods and services disturbs the market and leads to unfair competition.

One of the most contested aspects of pricing in recent years has been the issue of dual pricing by governments. To present it more clearly, governments create more favorable situations for their manufacturers and consumers by providing prices lower than the world price for them. What has caused conflicts in international trade is the dual pricing for important commodities such as energy because all countries depend on energy for their national and international development. This has caused complete dependency of global and domestic productions on energy in a such way that countries will cease to operate without access to energy.

Developed countries, which are also importers of energy, regularly object to the dual pricing policies of developing countries. For countries like the USA and the European Union, setting lower prices for energy and raw materials are considered a kind of subsidy, which disturbs market equilibrium. This is why these governments decided to pursue their protests through the most important international trade organization, namely, the WTO.

As a matter of fact, most countries, including energy importers and exporters, are members of the WTO, through which about 95% of the international trade is carried out. However, the WTO has not specifically addressed energy trade and related issues such as dual pricing, which may be owing to the absence or unwillingness of energy-rich countries at the time of the establishment of the WTO and GATT. Therefore, in the event of a dispute over energy trade, we will have to refer to the general rules and current agreements of the WTO. The rules of this organization regarding the mechanism of maximum price control or state-owned companies are inadequate to counter the dual pricing policy. Other agreements of this organization, such as Paragraph 9 of Article 3 of the Agreement on Subsidies and Countervailing Measures, do not merely include obligations to limit governments in setting dual pricing. Therefore, the current rules of the WTO do not oppose dual pricing.

Claiming that determining prices lower than the world price for energy has an impact such as subsidies for energy, energy importing countries rely on the WTO Agreement on Subsidies and Countervailing Measures in order to countervail their own damages. The important point is that considering a price below the actual price of energy and granting subsidies to manufacturers is not consistent with the concept of subsidy mentioned in the agreement. In other words, in order to cope with government subsidies, these

subsidies must be specific and be among the prohibited or at least actionable subsidies. However, a study of the accession negotiations of the energy-rich countries shows that the subsidies granted by these governments are distributed equally across all manufacturing units. For example, Russia or Saudi Arabia subsidize all manufacturers, regardless of their activity type and nationality. However, they had to abandon their pricing policy in order to accede to the WTO. These measures appear to be rooted in political issues rather than commercial considerations because, despite the WTO disagreement with dual pricing, its members relied on extra-organizational obligations to make the energy-rich countries gradually or suddenly eliminate dual energy pricing.

Iran, as one of the largest energy-rich countries, has been acceding to the WTO for more than 20 years, and is now one of its observer members. Iran is also one of the largest subsidy providers. By intervening energy pricing, this country supports its manufacturers and indirectly enhances their competitive power in global markets. Therefore, one of the most important commitments of Iran for the accession to the WTO is to reform its energy pricing policy and eliminate the considerable subsidies it pays for its petrochemical products (Jensen & Tarr, 2002:3-8).

An investigation into the patterns of energy-rich countries in the WTO demonstrates that if Iran joins this organization, it will have to reform its laws and regulations. It is important to note, however, that Iran has adopted laws such as the five-year development plans and the TSL to reduce its intervention in price setting and subsidy granting, and these actions show the efforts of Iran to align its trade laws with the WTO standards (Kojima, 2009: 43-44). Nonetheless, the price of energy carriers in Iran is still far from the actual price of energy in the world.

Despite the legal vacuum and the silence of the WTO agreements on dual pricing, governments are required to turn the prices of energy carriers into actual prices and to avoid granting subsidies to this sector because although subsidies enhance the competitive power of manufacturers and their share in world markets in the short run, this artificial price reduction will have numerous adverse effects on the trade and economy of governments.

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