Energy subsidies

Price squeeze

Popular and harmful, energy subsidies are hard—but not impossible—to kill

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Cutting energy subsidies is difficult. Their drawbacks are huge: they distort the economy, fuel corruption, bust budgets and, perversely, benefit the rich, as big users of energy, far more than the poor. They suck money from health care and education. Yet ending them can turn poverty to destitution—and rage. Rulers in Egypt, Indonesia, Nigeria and many other places know that to their cost.
Nevertheless, a surprising number of countries have made inroads. A study by the IMF last year of 28 reform attempts found that 12 were fully successful and another 11 partially so.

Outside pressure can be a good spur. Rising oil prices make costs (or, in the case of petro-states, opportunity costs) balloon. That has encouraged many countries to start shrinking their subsidies. After prodding from the IMF and under threat of a credit-rating downgrade, Ghana cut subsidies for gasoline, diesel and liquefied petroleum gas last year. (In 14 of the 28 cases in the IMF survey countries were getting money from the fund.)

Public-information campaigns are crucial. Indonesia sent text messages explaining the new policy. The Philippines organised a nationwide road-show. The Ugandan authorities persuaded the media that replacing subsidies with cash payments would help the poor.

Depoliticising the issue helps, too. Morocco, which has ended petrol and fuel-oil subsidies and made big cuts to diesel subsidies, is now indexing energy prices to international benchmarks.

India highlights another element of success: phasing out subsidies slowly. The new government of Narendra Modi is continuing the reforms of its predecessor, which began reducing the diesel subsidy (petrol is already deregulated) early last year; at the current pace it will disappear altogether by 2016. The latest half-rupee ($0.008) rise came as planned, on June 1st. The overall cost of subsidies should drop from about 1% of GDP in 2013 to less than 0.5% in 2016 (though much of that may be offset by the rising food subsidies).

Iran, beset by sanctions and an ailing economy, is steadily cutting too. In April it raised the price of the 60 litres of subsidised petrol that Iranians are entitled to buy each month from 4,000 rials ($0.12) to 7,000 rials. The price of other petrol rose too. A compensation programme of monthly cash transfers, of 455,000 rials, aims to soften the impact—though it has proved hugely costly following a decision to pay everyone, not just the poor.

Targeting cash transfers works better: it featured in a successful electricity-price reform in Armenia. Public-works programmes and expanding other programmes that help the poor (such as public-transport subsidies) work well too.

But ultimately, political will is crucial. In Indonesia, though the current president has cut subsidies three times in his eight-year tenure, prompted each time by pressure on the budget and current account, they still outstrip spending on health, education and housing combined. They long ago turned the country, a big oil producer, into an energy importer. As the leading presidential candidates, Prabowo Subianto, a former general, and Joko Widodo (Jokowi), the governor of Jakarta, debate how to get the country’s stuttering economy moving, the ballooning subsidy bill—this year a likely $24.5 billion—is again on the agenda. Jokowi’s team says it is “considering” phasing out subsidies over four years or so. By local standards, that counts as high political courage.

Elsewhere, progress is patchier. In Nigeria subsidies cost an annual $6 billion, or around 20% of the
federal budget. Policymakers such as Ngozi Okonjo-Iweala, the finance minister and a former World Bank director, agree that the policy is wasteful, but progress is scanty. A directive in 2009 by the president of the day, Umaru Yar’Adua, ordered kerosene subsidies to be ended, but this was never implemented. A subsidy cut in January 2012, which doubled petrol prices overnight, triggered protests that brought the country to a standstill, until the government backed down. President Goodluck Jonathan has shown no appetite to reopen the issue, even though a parliamentary probe has uncovered a huge scam based on subsidies claimed on billions of non-existent litres of fuel.

An even more grievous example is Egypt, which combines a prodigious subsidy programme for its 85m people (petrol costs less than the cheapest bottled water) with modest hydrocarbon reserves. Subsidies cost over $17 billion, 10-12% of GDP (education accounts for under 4%).

An attempt to cut food subsidies in 1977 brought riots against the Anwar Sadat regime. His successor, Hosni Mubarak, ignored the issue, while costs rocketed. Muhammad Morsi, during his brief spell in power, flirted with a fuel-subsidy cut as part of a possible IMF deal. Abdel Fattah al-Sisi, Egypt’s new president, has made it clear that he understands the need to cut subsidies but has been cautious in making promises. His proposals so far are flimsy: suggesting that foreigners pay higher rates and proposing the use of energy-efficient light bulbs. More effective might be to remove subsidies to manufacturing first.

Marching fastest in the wrong direction is Brazil. Dilma Rousseff, the president, pledged in 2012 to slash electricity bills by a fifth, offering to renew the concessions of power companies that co-operated. That led to a surge in demand, just as hydropower generation (which produces 80% of Brazil’s electricity) was struggling with the worst drought in 40 years. Filling the gap with fossil fuels is costly. With a general election looming in October the finance minister, Guido Mantega, has conceded that on top of 9 billion reais ($3.9 billion) so far this year, another 12 billion reais would be needed to prop up electricity utilities, to be financed in part by private banks. The Brazilian Centre for Infrastructure believes the government will end up paying the whole bill, which may reach 50 billion reais in 2014.

Petrol prices in Brazil have been capped since 2006, meaning that Petrobras, the partly state-owned oil giant, must import petrol and diesel to sell at a loss. This has cost it an estimated 48 billion reais in the past three years alone, according to Credit Suisse, a bank, while the government has lost 15 billion reais in forgone dividends. Its stake in the firm has shed nearly half its value since 2010. To put the cost in perspective, subsidised energy cost Brazil 0.4% of GDP in 2013—about the same as the World Cup, but a lot less fun.

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