

# The Quest for Subsidies Reforms in the Middle East and North Africa Region

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# Background

- 2005-2010 rise in oil prices, 2008 global financial crisis, rise in budget deficits, subsidies as the main culprits
- 2010 surge in demand from governments, 2011 revolutions, 2011-2014 quest for subsidies reforms
- 7+1 countries (Morocco, Tunisia, Libya, Egypt, Jordan, Djibouti, Yemen + Iran)
- Consumer subsidies (gasoline, diesel, LPG, electricity, bread, sugar)
- Multi-sector country team set up and embedded in government reforms teams
- Distributional analyses of subsidies, evaluation of reforms and simulations of further reforms
- 2015 Book: 8 countries, 18 contributors, 11 chapters
- This presentation: Chapter 1 – The Political Economy of Reforms

# Outline

- A brief history of subsidies
- What triggered reforms
- Who reformed, when, why and how
- What have we learned
- The unfinished business
- The distribution of remaining subsidies
- What will take to eliminate subsidies

# A Brief History of Subsidies

- 1940-1960 – Introduction of the subsidy systems as *price stabilization* mechanisms (*caisses de compensation*)
- 1970s – transformation into *social protection system*. This coincided with the turning of the MENA region towards socialism and the revolutions that put dictators into power between the 1950s and the 1970s. (Gaddafi's revolution, introduction of subsidies soon after in 1971)
- 1980s - *Enterprise support mechanisms*. Import substituting, infant industry protection or export oriented growth are some of the wording used to justify subsidies in this context. The search of a third way.
- 1990s - *Obstacle to economic development*. The socialist period in the MENA region came to an end during the 1990s when enlighten dictators, presidents and monarchs started to implement structural reforms including privatization and financial stabilization in the aftermath of the fall of the Berlin wall. But low oil prices.
- 2000s – *The last bastion of power*. The change in attitudes towards subsidies are generated by two concomitant factors. Subsidies are an obstacle to further reforms. The surge in oil prices generates huge budget deficits.
- But very few reforms

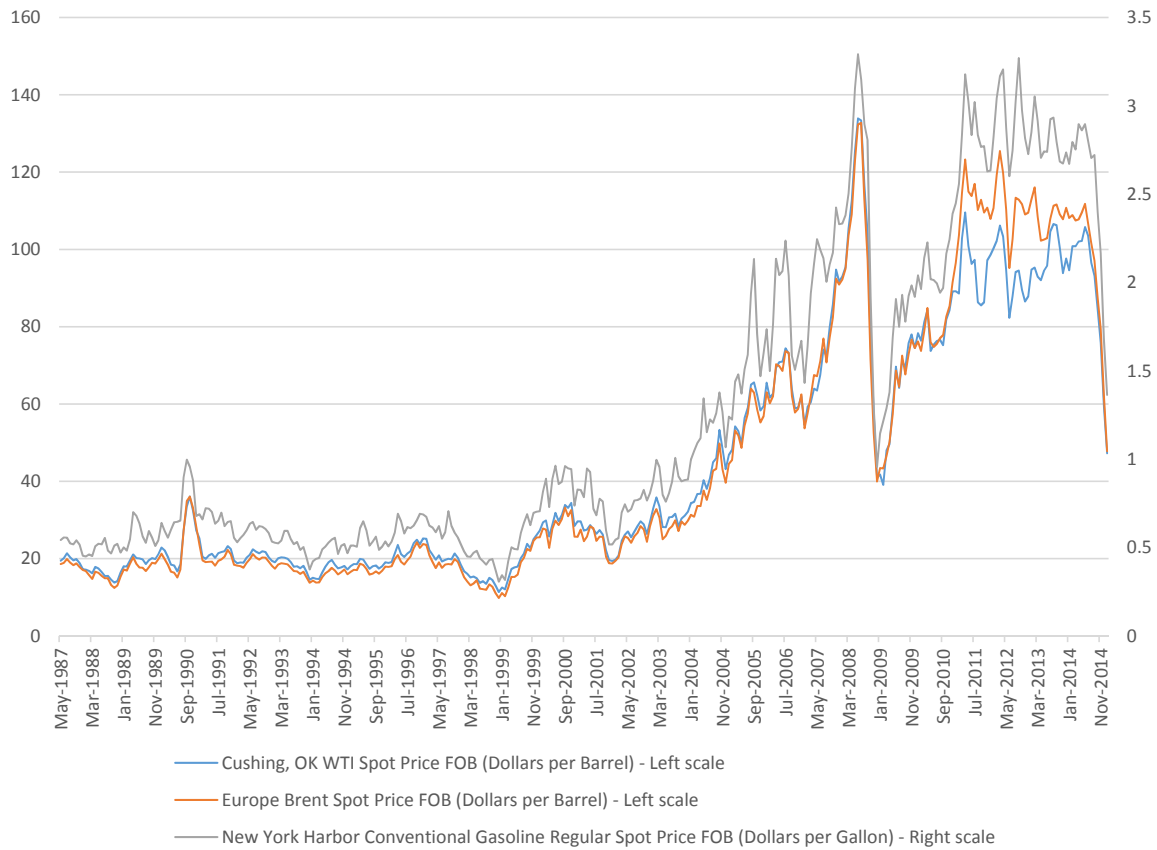
# Why Subsidies Persist?

Ten reasons to remove subsidies	Ten reasons to keep subsidies
<p>Political</p> <ol style="list-style-type: none"><li>1. Support undemocratic regimes and populist governments</li><li>2. Non-transparent to the population</li></ol> <p>Economic</p> <ol style="list-style-type: none"><li>1. Distort consumption</li><li>2. Distort production</li><li>3. Distort investments</li><li>4. Delay important strategic decisions on energy</li><li>5. Encourage informality and illegality</li></ol> <p>Social</p> <ol style="list-style-type: none"><li>1. Costly for the tax payers</li><li>2. Inequitable and pro-rich</li><li>3. Costly for the environment</li></ol>	<p>Political</p> <ol style="list-style-type: none"><li>1. Risk of social uprising</li><li>2. Buy political consensus</li><li>3. Benefit established monopolies/oligopolies related to politicians</li></ol> <p>Economic</p> <ol style="list-style-type: none"><li>1. Reduce production costs and increase export competitiveness.</li><li>2. Reduce price volatility, financial risks and uncertainty for households</li></ol> <p>Social</p> <ol style="list-style-type: none"><li>1. Work as social protection mechanism</li><li>2. Compensate for general increases in prices</li><li>3. Benefit the poor, the middle-class and the rich</li><li>4. Perceived as a basic human right</li><li>5. Increased demand for subsidies due to economic decline in MENA</li></ol>

# What Triggered Reforms?

- Political changes. Regimes changes in Tunisia, Libya, Egypt and Yemen changed the political settings in these countries and had a demonstration effect on countries that did not experience revolutions
- New social contract. Governments called to reform and populations less averse to reforms, including subsidies reforms
- Economic decline generated by the revolutions which follows the economic decline generated by the global financial crisis
- Very large budget deficits

# Spike in Oil Prices



# Spike in Commodity and Food Prices





## Relatively Low Initial Prices in MENA

	Gasoline	Diesel	Kerosene	LPG
East Asia and Pacific	\$1.25	\$1.03	\$1.11	\$1.20
Europe and Central Asia	\$1.16	\$1.23	n.a.	n.a.
Latin America and the Caribbean	\$1.24	\$1.14	\$1.18	\$1.01
South Asia	\$1.25	\$0.91	\$0.86	\$1.44
Sub-Saharan Africa	\$1.24	\$1.22	\$0.96	\$0.97
Middle East and North Africa	\$0.67	\$0.44	\$0.41	\$0.40

# Who Reformed, When, How and Why

## **Big bang reforms**

- Iran (December 18<sup>th</sup>, 2010)
- Jordan (November 13, 2012)
- Egypt (July 5<sup>th</sup>, 2014)

## **Gradualist reforms**

- Morocco (September 16<sup>th</sup>, 2013-October 1<sup>st</sup>, 2014)
- Tunisia (2012-2014)

## **No reforms**

- Libya, Yemen (conflict)
- Oil producers (less affected)
- Djibouti (only tax subsidies)

# What Have We learned

- Big bang vs gradualist approach (Iran vs Morocco)
- Compensation vs non compensation (Jordan vs. Morocco)
- Complementary fiscal and social policies
- Public information vs no information (Iran vs Jordan)
- Vertical vs horizontal reforms
- Poor vs middle class
- Stakeholders - The dark matter of subsidy reforms

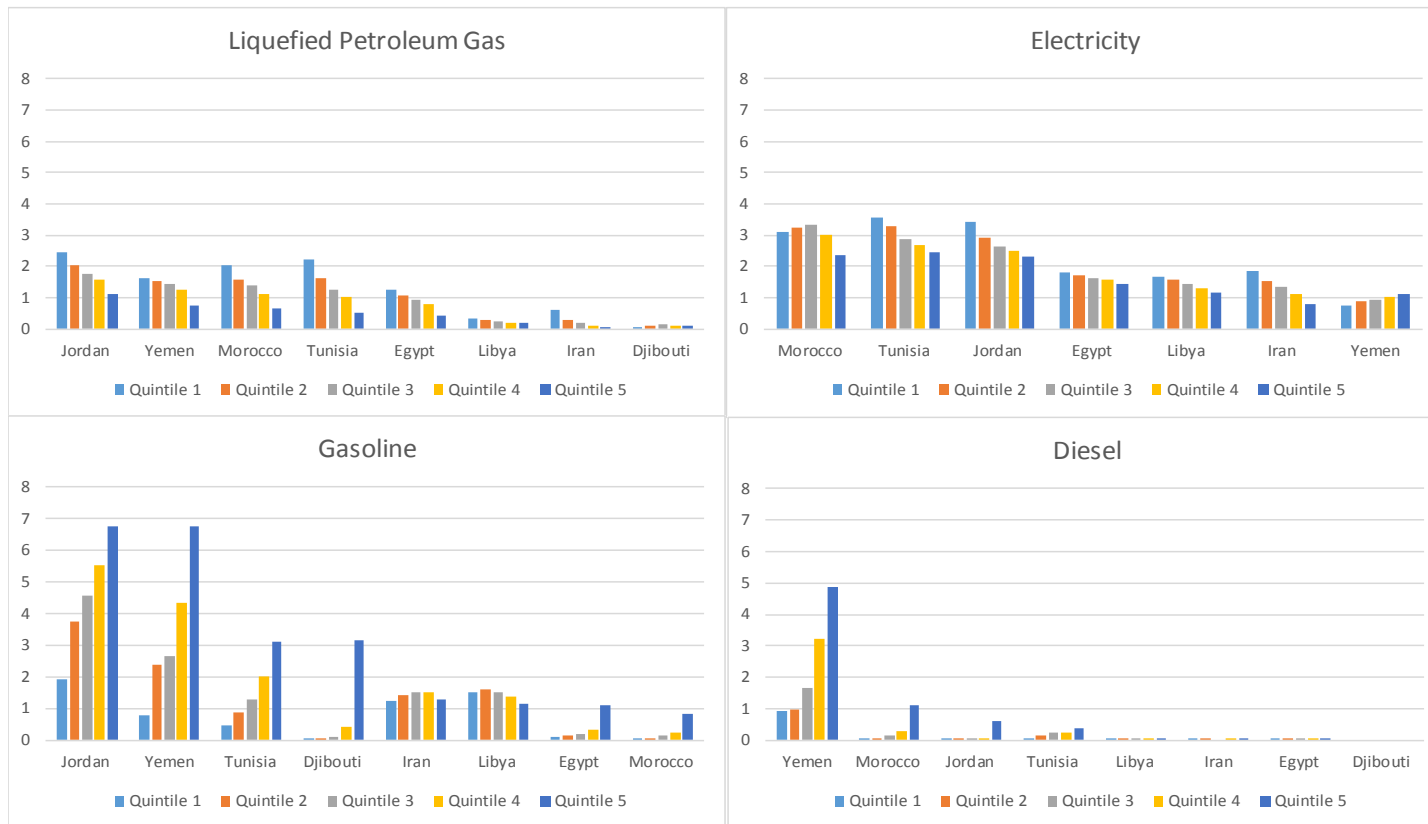
# The Unfinished Business

- Only one of the countries studied in the book is on the right track to achieve a complete elimination of consumer subsidies: Morocco
- Gasoline and diesel – gradual increases during low oil prices
- LPG – *ad hoc* reforms, combine with natural gas distribution
- Electricity – Tariffs reforms, prices and structure
- Food subsidies – Different political economy

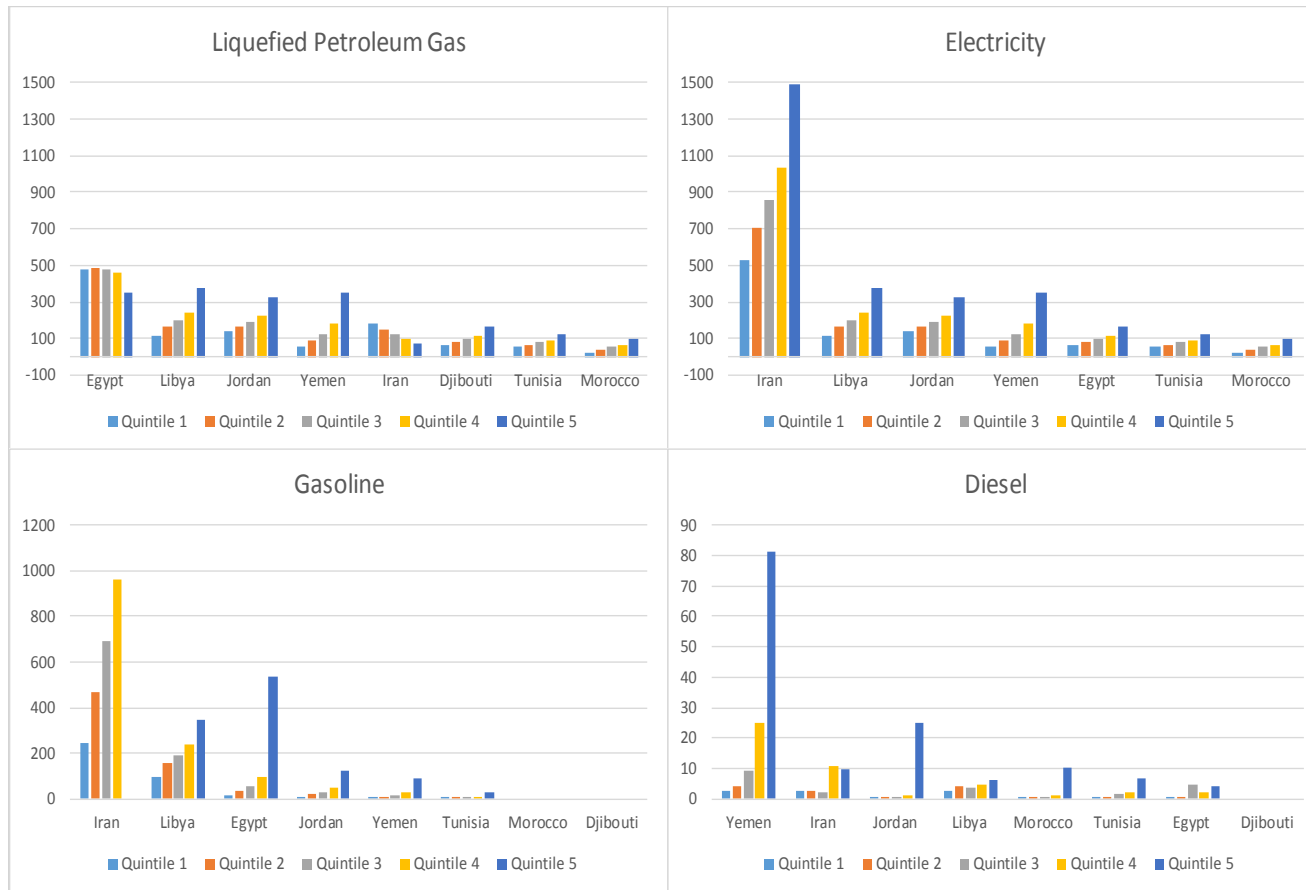
# Prices (USD-PPP)

	Price	Subs.	Subs. (%)	Increase (%)	Price	Subs.	Subs. (%)	Increase (%)
	LPG (13 kg)				Electricity (kWh, av.)			
Djibouti	28.3	2.8	9.1	10.0				
Egypt	3.9	10.8	73.3	275.0	0.04	0.28	87.6	705.9
Iran	1.9	9.7	83.3	500.0	0.18	0.25	58.5	140.7
Jordan	19.1	25.8	57.5	135.4	0.03	0.23	88.6	780.0
Libya	2.9	27.4	90.4	947.0	0.26	0.11	30.6	44.0
Morocco	10.4	20.7	66.6	199.8	0.21	0.15	42.3	73.2
Tunisia	9.8	20.9	68.0	212.7	0.11	0.63	85.4	583.0
Yemen	14.7	6.4	30.4	43.7	0.12	0.68	85.1	571.4
	Gasoline (L)				Diesel (L)			
Djibouti	3.0	-0.1	-2.0		2.1	0.3	11.1	12.5
Egypt	0.9	0.8	48.3	93.5	0.5	1.0	65.6	190.9
Iran	0.5	2.3	83.3	500.0	0.4	2.3	84.8	557.1
Jordan	2.1	0.3	12.5	14.3	1.5	0.5	24.6	32.7
Libya	0.2	1.6	87.7	714.7	0.2	1.6	88.1	740.0
Morocco	3.1	0.0	0.0		2.4	0.2	7.5	8.1
Tunisia	2.5	0.2	9.1	10.0	2.1	0.4	17.4	21.1
Yemen	1.6	0.3	17.8	21.7	1.6	0.4	21.1	26.7

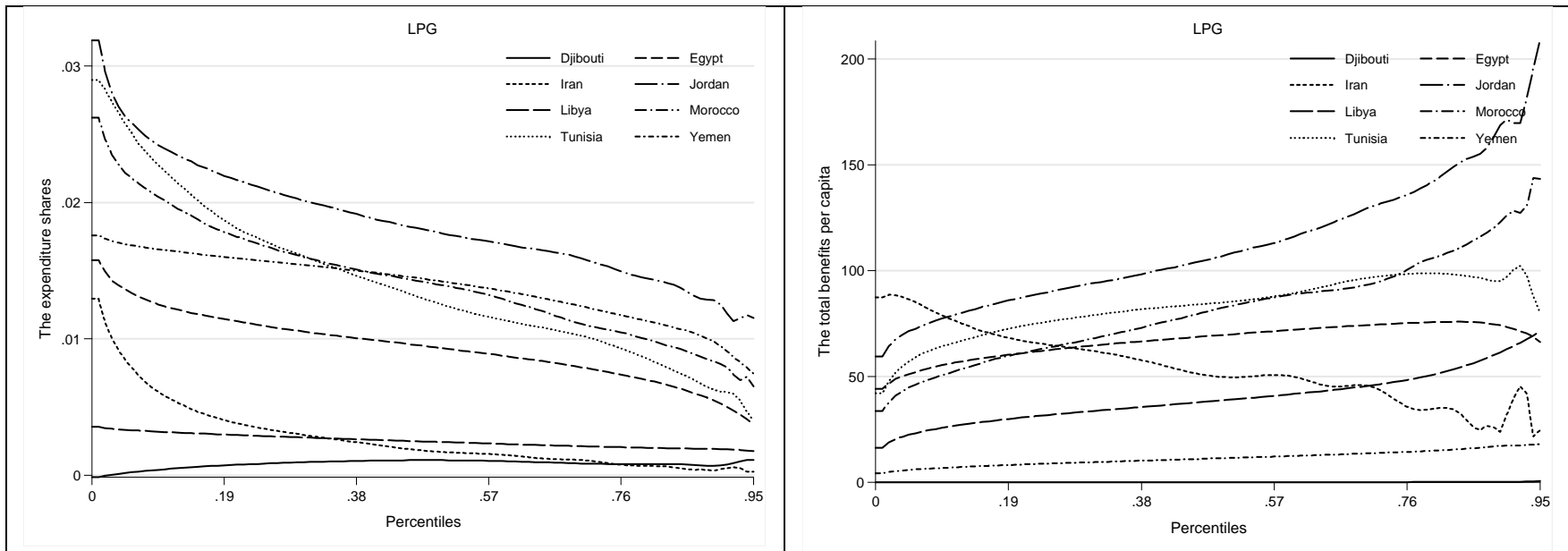
# How Important are Subsidized Products?



# Who Gets Subsidies?

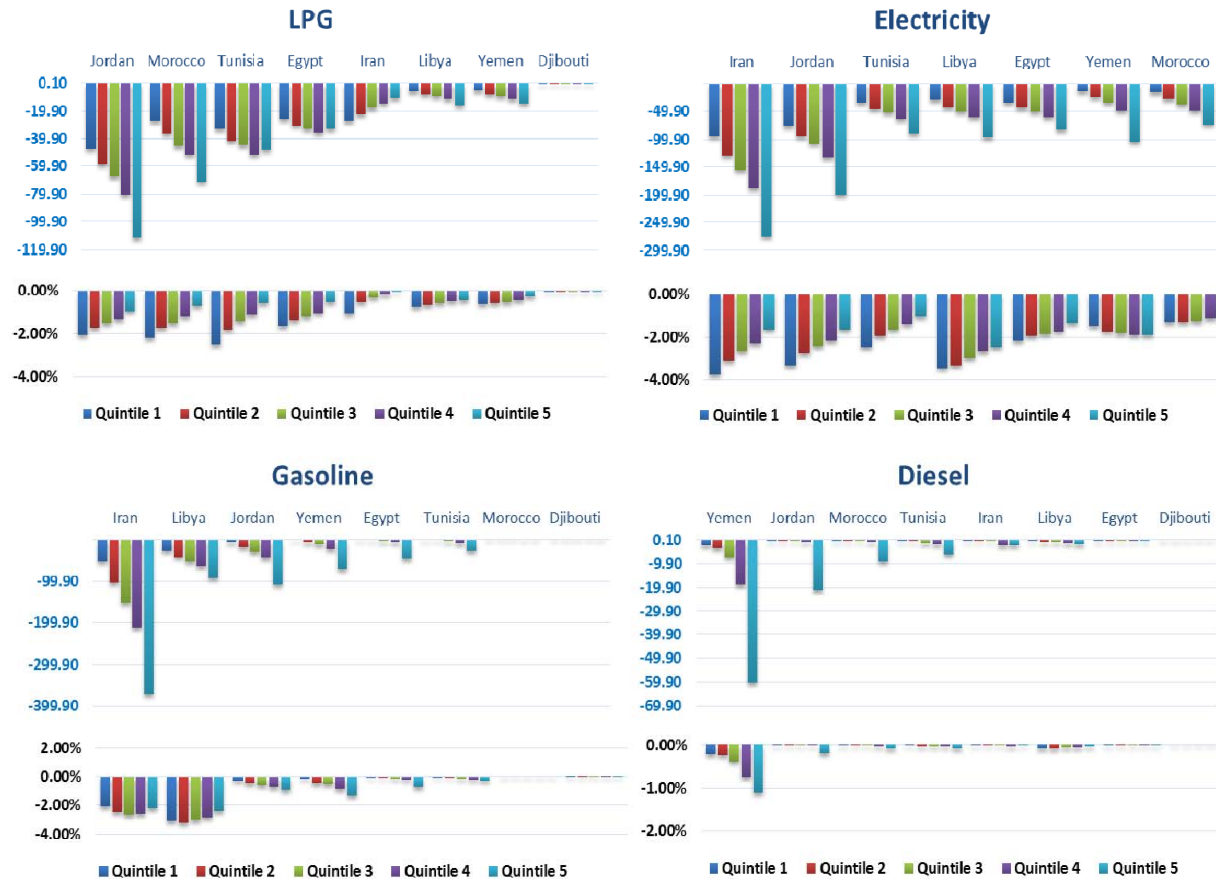


# A Policy Dilemma



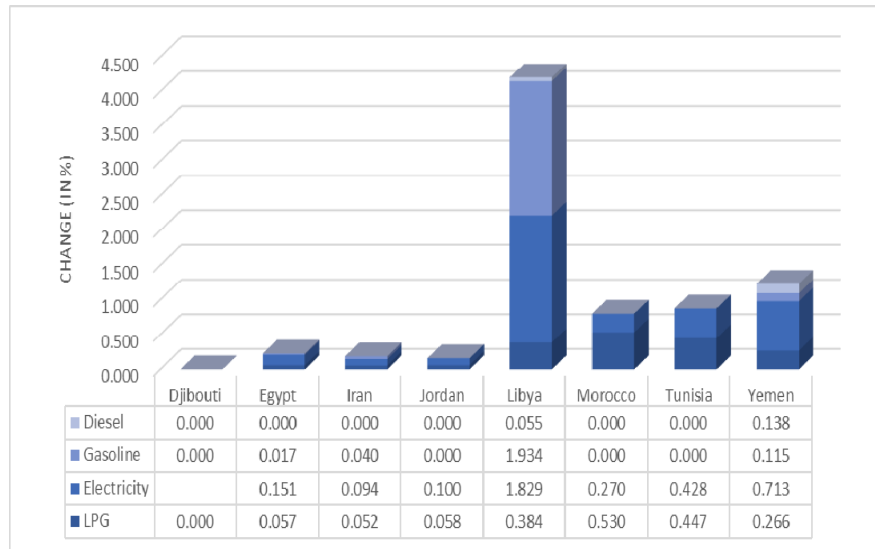


# Welfare Impact of Full Elimination of Subsidies

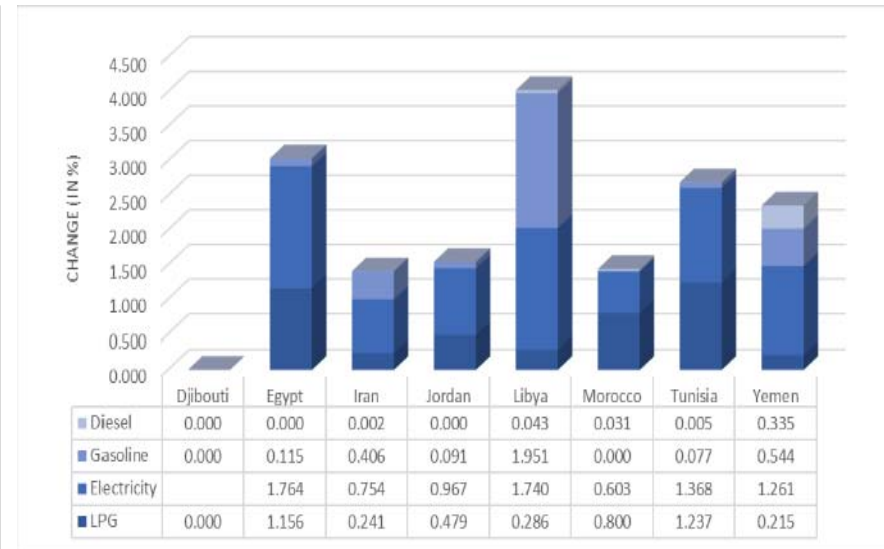


# Poverty Impact

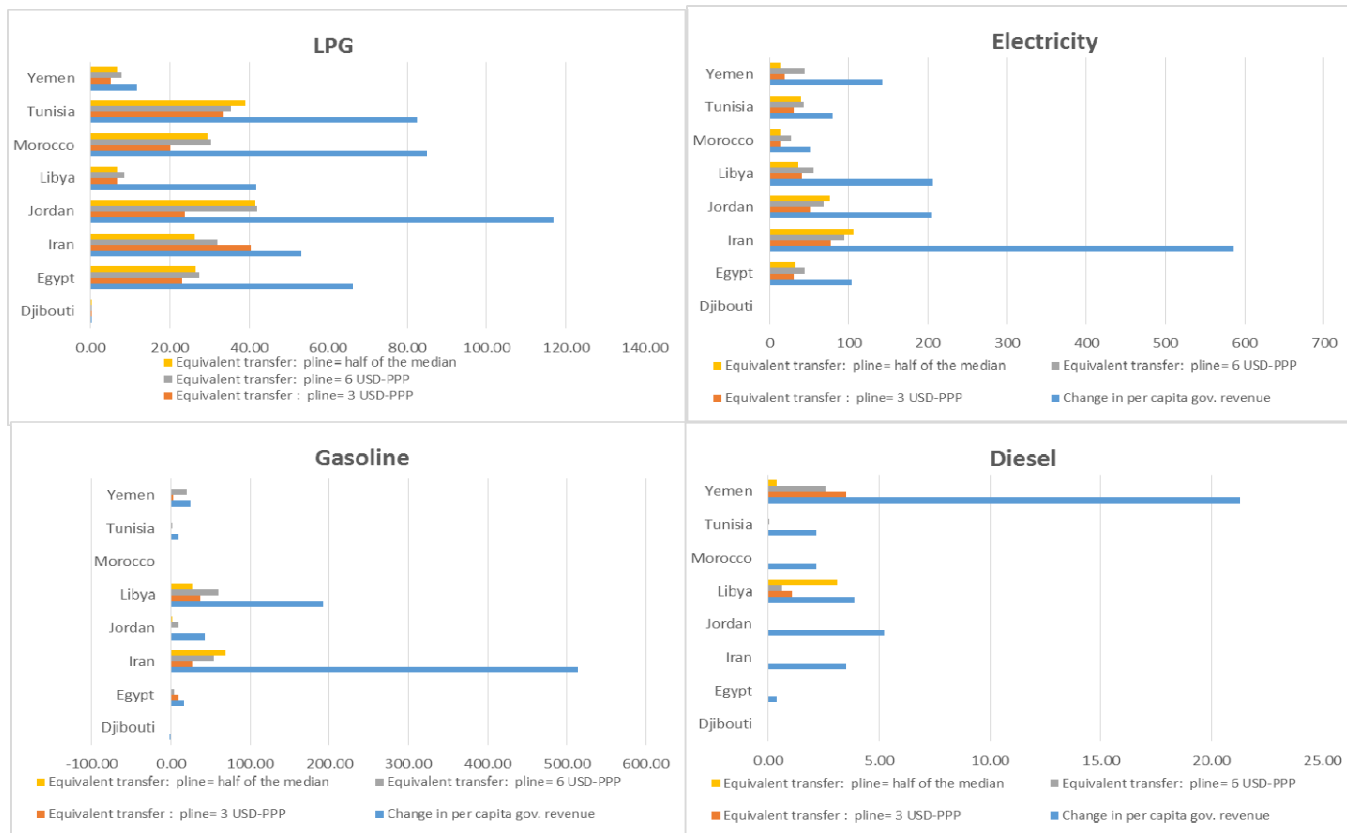
Poverty Line = 3 USD/Day



Poverty Line = 6 USD/Day



# Budget Trade-offs



# Conclusions

- Long history of non-reforms
- Reform momentum (2010-2014)
- Uncompleted reforms
- Low oil prices (Iran agreement)
- Opportunity to eliminate gasoline and diesel subsidies
- Big task ahead for LPG and Electricity
- Product by product approach