Knowledge, evidence and learning for development

Subsidy Reforms: Lessons from the Middle East and North Africa (MENA) Region

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Question

What are the lessons learned from implementing subsidy reforms in LMICs in MENA?

Contents

1. Overview

Subsidy reforms in the Middle East and North Africa (MENA) region have concentrated on changing fuel prices and electricity tariffs. Conversely, food subsidy reforms have received less attention, reflecting the comparatively small fiscal cost of food subsidies and their high social sensitivity. While countries' experiences have common characteristics, they differ in terms of preparation, scope of reform, and speed of adjustment.

Successful subsidy reforms in MENA countries (and elsewhere) were in general based on well-prepared plans, which were part of a broader fiscal consolidation strategy, and in some instances were backed by public communication campaigns. Some of the countries that raised prices sharply saw these gains knocked out by high international oil prices and exchange rate depreciation. On the other hand, many MENA countries (e.g. Jordan, Mauritania, Morocco, and Tunisia) implemented a price adjustment mechanism to bring domestic fuel prices up to international levels. The reforms were supplemented by some compensation, either through the introduction/strengthening of targeted mitigating measures such as cash transfers, or less effective measures such as public sector wage increases (IMF, 2014; Sdralevich et al., 2014).

Political economy factors present perhaps the greatest challenges. Barriers can take the form of resistance on the part of a small but organised group of potential losers from reform; the lag between the immediate loss of subsidies and the future benefit from more targeted and efficient social spending; and the loss of trust in the state's ability to introduce and manage social safety nets while not misusing the savings. These areas of opposition can be resolved through suitable reform design, including building an objective case for reform; growing transparency and leveraging communication campaigns; forming coalitions of beneficiaries from reforms; and incorporating reform in a wider reform plan (IMF, 2014; Sdralevich et al., 2014).

Some of the key lessons from case studies on countries in the MENA region include the following.

- In Egypt, subsidy reforms were passed (starting from 2014) to free up extra resources for investment in social and human development. This was necessary since, for instance, energy subsidies were taking up to a fifth of public expenditure. Egypt also had a wide range of subsidies on electricity, water and food. However, the subsidies (apart from food subsidies) were regressive – i.e. mainly benefiting richer groups. Following the successful passing of these reforms, Egypt has moved from a system of inefficient universal subsidies to more targeted social safety nets – such as targeted cash transfers and the use of smart cards to reach the poorest communities.
- In Jordan, expensive fuel and electricity subsidies had become unsustainable. The recent regional political instability – which has disrupted supply chains and created strains on public finances – had made the situation worse. As the subsidies became fiscally unsustainable, the government introduced reforms, e.g. lowering and/or totally removing subsidies on different fuel products. Due to strong popular opposition to the reforms (which had made life more expensive), the government introduced targeted mitigating measures that included large scale cash transfers to the poor and needy.
- In Mauritania, high global fuel and food prices and domestic fiscal constraints had forced the government to pass subsidy reforms. An initial reform attempt in 2008 had failed due

to poor planning and lack of complementary mitigation schemes to those adversely affected. The follow up successful reform in 2011 improved on earlier failures and explicitly set up mitigation strategies. Its success also partly emanates from the involvement of external partners such as the IMF – which assisted in the design and implementation of the reforms; the World Bank and the French Development Agency – which helped in the restructuring of the country's biggest public electricity company; the World Food Programme and UNICEF – which assisted in the design and implementation of social safety nets.

- In Morocco, subsidies on wide range of items (e.g. fuel, gas, sugar, and flour) had stayed in place, despite their inefficiency and the considerable fiscal strain they created on the country's finances. A combination of political reforms that empowered the government facilitated the passing of subsidy reforms by early 2010s. like other successful reformers, Morocco has complemented its subsidy reforms with targeted large-scale social programmes.
- In Yemen, successful fuel subsidy reforms were passed in 2005. Nevertheless, overall expenditure on subsidies remained high because of price rises on different subsidised items. Lessons were taken from the 2005 reform to pass a more successful reform in 2010 (followed by further price amendments on oil products in later years). This was done with the help of the IMF and World Bank. The reforms were also accompanied by additional efficiency enhancing measures. Furthermore, a Social Welfare Fund was launched to carry out conditional cash transfers.

This rapid review looks at different types of pertinent literature – including reports issued by multilateral financial institutions that are usually major proponents of subsidy reforms (e.g. IMF and World Bank); international development agencies that are often interested in supporting the design and implementation of social protection schemes that will be complementary to subsidy reforms; relevant government agencies, as well as some academic publications.

The report is structured as follows. Section 2 briefly discusses the key lessons from various countries on subsidy reforms (e.g. fuel subsidy, electricity subsidy, food subsidy). Particularly, the section discusses the potential gains from successful subsidy reforms; how periods of 'crisis' can be opportune moments to carry out reforms – instead of just being periods of challenge; and why social protection policies are needed to mitigate the adverse effects of such reforms on the poor. Section 3 briefly deliberates on the key issues in subsidy reforms in the MENA region – including their considerable fiscal burden to governments; their inefficiencies in benefiting the poor; and how they create market distortions. Importantly, Section 4 presents case studies of subsidy reforms in Egypt, Jordan, Mauritania, Morocco, and Yemen.

2. Key Lessons from Subsidy Reforms (Global Evidence)

2.1 Potential Fiscal Gains from Reforms (Costs of Subsidies)

The money spent on subsidies is usually redirected from public budgets that could have been used in other important areas, such as investments in education and infrastructure. Energy consumption subsidies, although intended to benefit the poor, are usually regressive because the bulk of the benefits accumulate to those with the greatest levels of consumption, i.e. those at the top of the income distribution. Subsidy programmes also distort energy markets by promoting excessive consumption overall while shifting demand toward subsidised products and away from those products with pricing that properly reflect real market conditions (Inchauste and Victor, 2017).

Problems linked to subsidies are widely recognised. However, the total global level of subsidy stays high. Consumer and producer subsidies were calculated at 0.7% of global gross domestic product (GDP) in 2013 (Coady et al. 2015). That is because subsidies, for all their distortions to the function of government and energy markets, are often hugely popular politically. Subsidies typically start as a price stabilisation policy, usually in the form of price controls. Organised consumer groups around the world have credibly demonstrated that they will mobilise (even to the point of revolt) when the price of essential products increases to unacceptable levels (Inchauste and Victor, 2017).

A study on the political economy of energy subsidy reform is especially relevant today since the sharp decline in several energy commodity prices in recent years has generated an opportunity for reformers (CFR, 2015; Klevnas et al., 2015). Cheaper prices for crude oil and products have implied that the subsidy required to sustain price controls is much lower. Nevertheless, in some countries, the perpetuation of price controls set in the era of elevated global prices signifies that, in effect, programmes that used to create subsidies are now raising the local cost of energy products comparative to global markets. For commodity-exporting countries, lower prices have caused huge fiscal pressure on governments, and this in turn has created pressing needs for reform (Inchauste and Victor, 2017).

When the recipients of subsidies are large in number and widely spread among the public, the political difficulty is likely much tougher for policymakers to resolve. Special interest groups may also profit from subsidies. For instance, the broad public gained considerably from the subsidy programme in Indonesia. Even poor and vulnerable households, who did benefit comparatively less from total spending on subsidies, found that the potential gain was relatively large as a proportion of their incomes. Likewise, in Jordan, the wealthiest quintile obtained three times more in fuel subsidies on average than the poorest quintile, but the level of kerosene and Liquefied Petroleum Gas (LPG) subsidies for poorer income groups was fairly high as a ratio of their expenditures (Atamanov et al., 2015). In these environments, the benefits from the subsidy are noticeable to the broader public. The public also carries the costs since the subsidy scheme is financed by state budget (Inchauste and Victor, 2017).

2.2 Important Lessons

Periods of crisis offer a window of opportunity for subsidy reforms:

As many studies have shown, big reforms often occur during a crisis. This is because a crisis can dramatically increase the credibility of reformers. There are no other options if the government has already depleted local policy choices and is turning to outside lenders (e.g. IMF) for support. Crisis is typically a driving force for reform among the many cases where countries have quickly adopted radical reforms–like in Iran, which eliminated one of the world's biggest energy subsidy regimes as the government confronted fiscal crisis from the cost of trying to cover fast growing oil product imports (Guillaume et al., 2011; Hassanzadeh, 2012; Inchauste and Victor, 2017).

Various country studies show that political leaders frequently ignore the necessity for energy subsidy reform when subsidies don't create conspicuous costs. However, reforms are difficult to avoid when costs get out of hand, as the following examples attest:

- In Indonesia, the government was in the run-up to the budgetary crisis in November 2014 when it introduced a fuel price rise since the previous budget did not allow higher than planned spending on fuel subsidies (Inchauste and Victor, 2017).
- In Jordan, the 2012 subsidy reform was also fuelled by an unaffordable primary fiscal deficit, a worsening in reserves, and an external current account deficit of 12% of GDP (Inchauste and Victor, 2017).
- In Ghana, oil subsidies sparked severe liquidity challenges, fuelling a price deregulation reform in 2015–a job made politically easier by the collapse of world oil prices (Inchauste and Victor, 2017).
- In the Dominican Republic, the economy was wrecked by the rising oil prices and the international economic crisis in 2008/2009–two exogenous incidents that popped up the cost of the subsidy while also reducing the country's tax base. These events have resulted in unsustainable fiscal costs, which have created enormous pressure on the government to plug its budget holes through the LPG subsidy reform (Inchauste and Victor, 2017).

Major fiscal crises are usually instances during which leaders have no alternative but to introduce policy change. However, sudden reforms themselves can also represent shocks that threaten their ultimate success. In the aftermath of the 1997–98 Asian financial crisis, Indonesia's long-discussed reforms of energy subsidies were suddenly needed–partly because of conditions set by the IMF and other external lenders (Beaton and Lonto, 2010). In the midst of the crisis, instead of following the planned phase-out subsidy strategy, the government announced sudden price increases of 25 % for kerosene, 60 % for diesel fuel and 71 % for gasoline (IMF, 2013). Violent protests and insurgency against the Suharto regime, which had been in power since the 1960s, followed (Rosjo, 2014). These political pressures compelled Suharto to withdraw from office next year, in 1998, and taught all Indonesian leaders who followed him about the dangers of shocks – in the form of energy subsidies reforms (Inchauste and Victor, 2017).

Improvements in social protection are critical to the success of reforms:

Governments have generally achieved overall savings, when shifting spending from broad-based consumer support programmes to better-targeted social programmes. Expectedly, the size of the savings depends on the degree of reform. For instance, the 2002 reforms in Indonesia was estimated to have saved around 2.5% of GDP, while the compensation package was reported to have cost only around 0.2% of GDP (Inchauste and Victor, 2017:11).

Cost savings were, at least initially, smaller–in cases where governments were concerned about political survival. For example, the 2013 subsidy cuts in Indonesia were estimated to have saved around 0.4 % of GDP, while the compensation package reportedly cost around 0.3 % of GDP, yielding a net savings of 0.1 % of GDP (Inchauste and Victor, 2017: 11).

Building credibility is vital when strong interest groups resist subsidy reform:

It is more difficult for governments to reform subsidies–if these schemes bring more benefits to well-organised interest groups (or evidently to an electorate). This is because reform entails costs (or fears of costs) that powerful interest groups will not accept. For instance, in Bolivia, President Morales had to cancel his move to remove fuel subsidies at the beginning of 2011, when pervasive unrest and the threat of a national transport strike followed. The outcome was a policy change that resulted in an increase (rather than a decrease) in subsidy expenditure from 0.9% of GDP in 2010 to 2% of GDP in 2014. Occasionally reformers find 'credible' ways to make shifts in the way benefits are delivered. In Ghana, for example, the government negotiated a trigger point with the local commercial vehicle transport union to avoid intermittent, unwarranted rises in transport fares in 2012. It was agreed that transport fares would rise by one-third of the fuel price rise–but only if the year's cumulative fuel prices surpassed 10% (Inchauste and Victor, 2017:12).

3. Key Issues in Subsidy Reforms in the MENA Region

Subsidies play a particular role in the MENA region, where generalised price subsidies have been part of the 'social contract' for decades. They often take the place of cash transfers and other types of direct income assistance that are not extensively used. Social safety nets (with the exception of subsidies) are not very well developed and are usually short of funds, comprising on average less than 0.7% of GDP in public spending (Sdralevich et al., 2014: 1).

As a result, MENA governments tend to deal with shocks by expanding subsidies or raising public sector employment and wages – as they have done in response to the increased social demands that have followed the wave of political transitions across the region. In several oil-exporting countries, low energy prices are seen as reflecting the low cost of extraction, which is not viewed as cost to the budget. In some countries, the sense of entitlement is firmly rooted, and low energy prices are seen as a right to citizenship and a key component of legitimacy, substituting for political participation (Sdralevich et al., 2014; IMF, 2014).

The cost of subsidies in the MENA region is substantial. Relative to other regions, subsidies expenditure (estimated on the basis of the gap between international and domestic prices) is on average much higher. This burden is more and more difficult to bear. Energy subsidies continue to account for the largest part of the overall expenditure on subsidies. Pre-tax energy subsidies in 2011 were estimated at USD 236.5 billion, equivalent to 48 % of global subsidies (or 8.6 % of regional GDP). They amounted to USD 204 billion (or 8.4% of GDP) for oil exporters and USD 33 billion (6.3% of GDP) for oil importers. In 2012, the available figures for diesel and gasoline showed that pre-tax subsidies for these products, which alone account for about half of MENA's total energy subsidies, represented 3.8% of regional GDP. Food subsidies are also common, albeit much less costly, at around USD 22 billion or 0.7% of GDP in 2011 (Sdralevich et al., 2014: 1).

Subsidies are often intended to attain several objectives at once. In the context of underdeveloped social safety nets, MENA governments rely overly on generalised subsidies to support real incomes and combat poverty via affordable prices on commonly consumed products, and to protect the population from shocks caused by large volatility in commodity prices and exchange rates, especially in oil-importing countries. In oil-producing countries, subsidies are also a tool for spreading the wealth of natural resources among the population. In several MENA countries, governments are helping certain industries and promoting employment in the private sector–through producer subsidies, such as lower market prices for energy inputs (IMF, 2014).

Subsidies are often ineffective and biased against the poor. Broad price subsidies (the most common form in the MENA region) are neither well-targeted nor cost-effective as a means of social protection. Although they may reach the poor to some degree, they most often benefit the better-off, who consume more of the subsidised goods, especially energy products. In 2008, for example, the poorest 40% of the population in Egypt obtained only 3% of gas subsidies (Sdralevich et al., 2014: 1).

In addition, subsidies (especially for energy products) introduce welfare costs by distorting relative economic prices, which facilitates the over-consumption and misallocation of resources. This, in turn, decreases exportable resources and therefore lowers the accumulation of wealth for energy-exporting countries, eroding the current account of energy-importing countries. Furthermore, overconsumption contributes to adverse effects of traffic congestion, health and the environment, and inefficient specialization of domestic production, often in less labour-intensive and energy-intensive sectors. Subsidies also discourage investment in the energy sector and facilitate smuggling and black-market activity, which may lead to a scarcity of subsidised products. Importantly, subsidies are damaging to growth. While they can be used to provide short-term support to the productive sector, long-term subsidies have a negative effect on growth potential via price distortions, under-investment in labour-intensive and energy-efficient sectors, crowding out productive expenditure on human and physical capital, and increasing inequalities linked to inefficient support for the poor (Sdralevich et al., 2014).

4. Case Studies on Subsidy Reforms in the MENA Region

4.1 Egypt

Gains from Reform

- **Following Egypt's reforms on fossil fuel subsidies, more budget was available for social spending** (as the cost of subsidies decreased from around 7.0% of national budget in 2013/14 to 3.0% of the budget in 2015/16 and 2.7% of the budget for 2016/17). It was noted that price reforms accounted for about one-third of the decrease in subsidies costs between 2014 and 2016 (World Bank, 2017a).
- **Fiscal savings from energy subsidies reforms have been rerouted to social spending in areas such as health and education.** Supported by the World Bank's technical assistance, the social programs have been significantly reformed to mitigate the impact of the reforms (World Bank, 2017a).

Description of Subsidies and Reforms

In Egypt's state budget, energy subsidies accounted for up to 20% of public expenditure and skewed policy choices in a number of other key areas (e.g. health and education investment). Energy subsidies have also altered the market and contributed to the expansion of energy-intensive industries, which has further worsened pollution (The Egypt Network for Integrated Development, 2012; Jawad et al., 2018).

The recent reform of energy subsidies in Egypt began in July 2014 and included an incremental elimination of subsidies over a period of 5 years (even if some modest cuts in subsidies have been made in the past). Expenditure on food and energy subsidies and social protection declined from 39% of public expenditure in 2014/2015 to 28.6% in 2015/2016 (Central Bank of Egypt 2016), with fuel prices rising by almost 70% and natural gas prices rising by 175%. Electricity tariffs were expected to double within five years (Ghanem, 2014; Jawad et al., 2018).

Food subsidies covered a certain number of basic commodities (sugar, oil, rice, tea) and Baladi bread (accounting for over 70% of the cost of food subsidies) through a 'household ration card'. In the meantime, **fuel, gas, water and electricity subsidies represent more than 63% of total public spending on subsidies** (Central Bank of Egypt, 2016; Jawad et al., 2018).

Energy subsidies are characteristically regressive in Egypt, generally benefiting middle- and higher-income groups with access to infrastructure and cars. Besides food subsidies, the elements of social policy are usually regressive in favour of middle-and higher-income groups, particularly those in urban areas. Energy subsidies do not reach the residents of urban slums. In fiscal year 2014/2015, expenditure on food and energy subsidies accounted for 35% of total public expenditure (Central Bank of Egypt, 2016; Jawad et al., 2018).

In 2014, the government embarked on a sequence of radical policy changes (i.e. with the advent of President Al Sisi), questioning the pre-existing social compact and moving from universal to targeted social policies. The reforms include the phase-out of energy subsidies and enhanced targeting mechanisms for food subsidies and cash transfers. Egypt has also moved to a flexible exchange rate regime following a series of sharp devaluations of the Egyptian Pound and the inability to keep adequate foreign reserves (Jawad et al., 2018).

Social Programmes to Ease the Adverse Effects of Reforms

Al Sisi's government is substantially cutting energy subsidies and moving from universal in-kind subsidies to **targeted cash transfers**. Nevertheless, more serious reforms and improved targeting have been continually postponed for political reasons (Jawad et al., 2018).

A new smart card system was implemented with a presidential decree in March 2015. Besides the subsidised commodity basket, the new card includes a quota of five loaves per day per person. In an initiative aimed at those in need, only those who obtain Baladi bread and receive equivalent points on their cards are given access to subsidised food products. **The shift to smartcards has culminated in a decline in recipients** from 16 million to 11 million. The Government has signed a USD400 million loan with the World Bank to introduce new food subsidies and cash transfer programmes–until subsidies reform savings are made and the implementation of the new programmes become financially sustainable (Jawad et al., 2018).

Half of the savings (EGP 51 billion or USD3.3 billion) are assigned to the reform and **expansion of social safety nets**. The Ministry of Social Solidarity launched two targeted cash transfer programmes in April 2015: Takaful and Karama. **Takaful** (solidarity) is a conditional cash transfer programme offering financial support to low-income families with school-aged children. The second programme, **Karama** (Dignity), offers income support to elderly people and people with disabilities that prevent them from working (Jawad et al., 2018). In 2015, the Takaful and Karama programmes benefited 1.5 million poor families (about 5.5 million people) (World Bank 2015).

The government rationalises the reforms to the public – stating that they are needed to prevent a severe macroeconomic crisis (Ghanem 2014). Simultaneously, the government adopts an argument focused on the value of '**sacrifice'** to justify ongoing reforms (Adly, 2014; Jawad et al., 2018).

Lessons from Key Success Factors

The current administration has implemented subsidies reforms and at the same time seeks to address poverty (using the financial gains from the elimination of subsidies). **Policies emerging under this administration target the household rather than the individual** as a means of breaking the cycles of poverty. The Takaful and Karama programmes have been popular as they seek to empower the household by integrating cash transfer and engaging in human development opportunities (Jawad et al., 2018).

The phasing-out of energy subsidies is expected to correct market distortions and lead to job-rich growth in the medium and longer term, i.e. by reorienting Egypt's comparative advantage to labour-intensive industries. In the short term, however, the restructuring of energy subsidies (together with the floating of Egyptian Pound and the subsequent inflation) have marginally raised the cost of energy-intensive industries (IMF, 2017).

4.2 Jordan[1]

Gains from Reform

- A simulation of the gains from the subsidy reforms in Jordan by Atamanov et al. (2017) demonstrated that the **elimination of subsidies for petroleum products would result in an increase in government revenues** of JD 389 million per year. Well over 70 % of the increased revenue comes from higher LPG prices and 20 % comes from petrol. They also estimated that the government saves JD 473 million from the complete **elimination of electricity subsidies**.
- Because the **subsidies were pro-rich in nature, with their elimination, richer households contributed more** in proportion to increased revenues: the poorest quintile (poorest 20% of households) accounted for only an estimated 11 % of the revenue increase relative to 35 % for the top quintile (richest 20% of households) (Atamanov et al., 2017).
- The cost of the cash transfer program introduced by the Government was approximately JD 320 million per year. Araar et al. (2013) estimated that **the cash transfer program overcompensated the majority** (almost 70%) of Jordanian households. Furthermore, Atamanov et al. (2017) estimated that only JD 206 million were required to have a pre-reform poverty rate if transfers were universal. If transfers are fully targeted to the bottom

[1] Jordan has very recently graduated from the Lower Middle-Income Countries (LMIC) group since its current Gross National Income (GNI) per capita exceeds the threshold of 3,995 (see World Bank, 2020). However, it still sits just above the LMIC threshold with a per capita income of around USD 4200 as of 2018 (World Bank, 2019).

quintile, only JD 41 million would be required to bring poverty to its pre-reform level (Atamanov et al., 2017).

Description of Subsidies and Reforms

Like other MENA countries, Jordan has historically provided subsidies for consumables such as fuel, electricity, gas and food. The Government of Jordan has safeguarded its citizens from varying global commodity and food prices, beginning with subsidies for wheat and sugar (Atamanov et al., 2015; Jawad et al., 2018).

However, in the early 1990s, liberalization policies and subsidy reforms eliminated most of the food subsidies except the one for wheat. Government efforts to remove wheat subsidies in 1996 led to a dramatic increase in bread prices and to social discontent and 'bread riots.' As a consequence, the reforms have been scaled back and supplemented by cash transfers to the poorest households to make up for higher bread prices. Continuation of subsidies for wheat, water and other commodities has led to sharp rises in government expenditure due to global market price spikes. In fact, in 2005, the government spent as much as JD 600 million (USD 846 million, current prices) on food and oil subsidies, or about 17 % of its total spending (Atamanov et al., 2015).

Despite efforts at enforcing further subsidy reforms since 2005, **recent regional instability has had a substantial impact on energy prices** and disrupted the supply of natural gas from Egypt. This has **led to the use of expensive imported oil products** to generate electricity. In order to prevent social and political unrest following the 2012 uprisings, the government protected consumers from soaring electricity costs, which led to an accumulated debt to the National Electric Power Company (Jawad et al., 2018). In 2012, subsidies for petroleum products alone made up for almost 9 % of government expenditure and up to 2.8 % of GDP in order to prevent social and political unrest following the 2012 uprisings, the government protected consumers from soaring electricity costs, which led to an accumulated debt to the National Electric Power Company (Jawad et al., 2018). In 2012, subsidies for petroleum products alone constituted almost 9 % of government expenditure and up to 2.8 % of GDP (Atamanov et al., 2015).

The sudden fiscal burden of subsidies (i.e. in the period since regional instability) proved untenable, and in November 2012, the government either lowered or completely removed subsidies for different categories of fuel. At the same time, to make up for vulnerable demographics, the government launched a large-scale cash transfer scheme for households with incomes below JD 10,000 (USD 14,000, current prices) per year. Despite the success of the elimination of these subsidies, the government is struggling to gain political support for the elimination of additional electricity subsidies, which are proving to be even more burdensome than fuel subsidies (Atamanov et al., 2015).

Subsidies in Jordan are inefficient and principally benefit the most affluent sections of society, who are the highest consumers of fuel and electricity. According to the 2010 Household Expenditures and Income Survey, the richest quintile in Jordan spends seven times more than the poorest quintile on subsidised petroleum products. Nevertheless, the implementation of further reforms has been met with resistance and remains to be a politically sensitive issue (Jawad et al., 2018).

Social Programmes to Ease the Adverse Effects of Reforms

Jordan offers a wide range of assistance programmes, including cash transfer schemes, tax exemptions and social services. For example, cash transfers to families are made below a certain income threshold if oil prices are above USD 100 (IMF, 2014). All in all, **Jordan is regarded to have one of the strongest social protection programmes in the MENA region** (Jawad et al., 2018).

Lessons from Key Success Factors

Jordan's reform experience shows that the poor and vulnerable can be better targeted (at a lower fiscal cost) through targeted programmes such as cash transfers–rather than inefficient subsidies that generally favour the better-off sections of society unfairly. For example, before the 2012 reform, energy subsidies received by Jordan's richest quintile were about 20 percentage points higher than those obtained by the poorest quintile, according to a 2008 household survey. The spillage of subsidies to rich households was most visible in the case of gasoline and diesel subsidies, where the richest quintile received more than six times more in the case of gasoline subsidies (and twelve times more in the case of diesel subsidies) than the poorest quintile (IMF, 2014). Additionally, IMF staff simulations for Jordan in 2011 showed that the gradual removal of price subsidies for energy products, bread and water, and the substitution by a well-targeted cash transfer system, could enhance the welfare of the poorest 40% of the population–while generating 5 % of GDP fiscal savings (IMF, 2014).

However, Jordan's experience also shows the political challenges and resistance to subsidy reforms. It has been contended that the (overall) trend in Jordan has been a slow but steady weakening of social protection policies in recent years–even though some government policies have reinforced some aspects of social protection (Achcar et al. 2017). Retrenchment of the state in providing sufficient services and social security has led to protests and public unease. In 2016, a record number of public protests were registered across Jordan in reaction to unemployment and the reduction of subsidies (World Bank, 2017b).

4.3 Mauritania

Gains from Reform

- The Government of Mauritania **implemented an IMF-supported subsidy reform,** along with wage bill containment. **This enabled the government to realise the desired fiscal adjustment (i.e. deficit reduction/fiscal saving)** objective (Clements et al., 2013; IMF, 2014).
- **The adjustment strategy was intended to free up resources while still enabling much-needed greater social and infrastructure spending** (Clements et al., 2013). The reform included mitigation measures as an explicit element of the energy subsidies reform programme. The financing of mitigation measures from the reform/price-savings (e.g. an increase in diesel prices by more than 20% over a five-month period in 2012) enabled to pacify public opposition to the reform (IMF, 2014).

Description of Subsidies and Reforms

The reform of energy subsidies in Mauritania was motivated by fiscal constraints (i.e. increasing government spending) as well as an increase in international fuel and food prices. The discovery of oil in 2006 contributed to large increases in public spending, in particular the wage bill (through wage consolidation) and subsidies. When, contrary to predictions, the discovery of oil turned out to be very small, it became evident that their funding was not viable, given Mauritania's reliance on unreliable mining revenues. The large increase in world fuel and food prices in 2008 and 2011 greatly raised fiscal strains. As a result, the subsidy reform (along with wage bill reduction), became the centrepiece of the government's fiscal transition policy (supported by the Extended Credit Facility (ECF) programme of IMF). The adjustment plan was designed to unlock funds while still encouraging the much-needed higher social and infrastructure spending in the country (Moers, 2013).

Starting in 2011, the Government made progress on a successful subsidy reform supported by the IMF's ECF programme. In May 2012, the Government introduced a new gasoline pricing model, negotiated with the oil distribution companies, adopting a simpler cost structure. The legislation was met with relatively limited criticism, despite an increase in price of more than 20% since January 2011. On the contrary, **an earlier attempt at energy subsidy reform in 2008 was unsuccessful.** The fuel price freeze at the beginning of 2008 resulted in huge losses for (all private) energy distribution companies. At the end of June 2008, the government raised the price of petroleum products by 17.5 % to 20 %. No public communication strategy has been introduced or particular mitigation measures have been adopted in the context of this fuel subsidy reform episode. Yet, **unlike in the 2008 episode, the implementation of mitigation measures in the 2011 reform was an explicit element of the energy subsidies reform strategy.** The technical assistance provided by the IMF was part of the policy discussion. Despite considerable rises in international fuel prices, the comprehensive application of the new streamlined automatic fuel price formula on a biweekly basis helped to bring domestic fuel prices up to international level by June 2012, which was a significant achievement (Moers, 2013).

High international prices have also exacerbated the cost of subsidies to the electricity sector. SOMELEC, the public electricity company that generates nearly all of Mauritania's electricity, has suffered major losses as a result of the rise in international fuel prices. Two-thirds of the electricity consumed in the country is produced by thermal plants, divided equally between diesel and fuel oil. Regardless of higher global prices, electricity tariffs have not been amended upwards in recent years. Residential and commercial tariffs are one of the lowest in the region and are calculated at more than 30% below cost recovery prices. A restructuring plan was laid out with the support of the World Bank and the French Development Agency (AFD). **A tariff study, undertaken by an international firm, was finalised in 2012 and culminated in electricity rates being increased, especially those paid by big consumers** (Moers, 2013).

Social Programmes to Ease the Adverse Effects of Reforms

In 2011, the Mauritanian authorities implemented emergency relief initiatives to reduce the impact on the poor of higher global fuel prices and a drought, which led to a food emergency. Unlike the 2008 emergency plan, the new package consisted mostly reversible initiatives (e.g., it did not include a raise in the wages of civil servants). It was worth about UM40 billion (3.4% of GDP) and was the biggest (in share of GDP) among the region's oil importers. It was therefore an enhancement over earlier measures, and some social response by the government was clearly needed (Moers, 2013).

Nevertheless, the government contemplates replacing this transitory programme with permanent well-targeted social safety nets. With the support of the World Food Programme, a start has been made with a cash transfer programme. This programme, which was quickly put in place, targets 10,000 vulnerable households in Nouakchott (capital city) that were identified via a recent poverty survey. The agenda of expanding such well-targeted cash transfer schemes should benefit from the expansion of the vulnerability and poverty survey to offer national coverage, as most of the poor reside in rural areas. **A broader social protection strategy formulated with UNICEF will also further enhance the coverage of the social protection system and better protect the poor and vulnerable.** The authorities are therefore planning, with the assistance of technical and financial partners, to strengthen programmes such as free school cafeterias, food-for-work and support for pregnant women. In addition, recognizing the adverse effects of drought on food security, a national food security strategy for the period 2015 to 2030 and a related national investment plan have been established (Moers, 2013).

Lessons from Key Success Factors

Depoliticizing fuel price reforms as much as possible will help pass initial price increases. The automatic introduction of Mauritania's diesel-price formula has been very successful at limiting the coverage of subsidies. Putting a cap on any single price increase would ensure that large international price swings do not lead to excessive retail price instability, which could weaken political support for the automatic fuel price formula. At the same time, such a price smoothing would still enable domestic prices to keep up with the trend in global prices (Moers, 2013).

Mitigating social policies will help to offset the increase in energy prices and their effect on the vulnerable, but they should be well-targeted. Mauritania's recent cash-transfer programmes, developed with the help of the World Food Programme, appear promising in this respect. On the other hand, the earlier emergency relief programmes were less well-targeted and not as effective. In addition, care should be taken to ensure that temporary emergency programmes do not become permanent entitlements, draining fiscal resources. To date, the lack of a fully-fledged communication campaign has not been a barrier to reforms in Mauritania. Nevertheless, the authorities are well advised to support the reform of the energy subsidies through an explicit communication campaign that explains its benefits to the population. Transparent reporting on the use of released budget resources should also improve public confidence in the results of the reform (Moers, 2013).

The linkages between the reform of fuel and electricity subsidies must be explicitly recognised and addressed. If the highly subsidised electricity sector uses large amounts of fuel, as in Mauritania, the increase in fuel prices may add to the difficulties in the electricity sector. In the case of public electricity utility companies, the reform should also be followed by clarity of their financial relationship with the government (Moers, 2013).

The involvement of donor partners specializing in other areas (e.g. social sectors) may increase the chances of success of the reforms. In the case of Mauritania, the role of the World Food Programme and UNICEF in the development of social mitigation strategies was obviously useful. The study on the restructuring of the electricity sector and SOMELEC, supported by the World Bank and AFD, was key to tackling electricity subsidies (Moers, 2013).

4.4 Morocco

Gains from Reform

- **The government made substantial savings from the subsidy reforms in the early 2010s**, as the budget for subsidies in 2014 fell from 48.8 billion Dirham to 25 billion Dirham (about USD 5 billion to USD 2.6 billion, current prices). This figure was estimated to have further decreased by the end of 2015–as fuel products are now fully regulated by market prices and no longer subsidised (Jawad et al., 2018).
- **Reforms at the beginning of the 2010s have been very effective in reducing the budget deficit while at the same time protecting the most vulnerable sections of the population via targeted social programs.** Subsidies were first removed on those products that were more pro-rich (e.g. gasoline) while the reform of products that would affect the poor the most (e.g. LPG) was delayed (World Bank, 2017c).
- **Morocco has also proven to be an effective example of how frequent and gradual price changes help gain acceptance of consumers. That is, consumers get used to domestic price fluctuations – mirroring movements in world fuel prices and exchange rates.** The country's experience also demonstrates that clear communication regarding these price movements can help guarantee that the pricing reform is sustained (World Bank, 2017c).

Description of Subsidies and Reforms

Morocco's system of subsidies has been a key part of the Moroccan social protection system for decades. The aim was to safeguard the purchasing power of the population in terms of food and fuel products (e.g. sugar, flour, butane gas and various types of fuel). Subsidies had become costly as their budget increased from 4.89 billion Dirham (about USD 500 million, current prices) or 1% of GDP in 2003 to 48.8 billion Dirham (about USD 5 billion, current prices) in 2011, hitting 6.1 % of GDP (Chen et al., 2014). Since the beginning of the 2000s, as food prices have risen globally, the Moroccan **subsidies system has been criticised for its increasingly high costs** representing large percentages of state budgets; and failing to address social inequities, as it has profited the middle classes and high-income groups to a great extent (besides supply chain businesses) instead of the poor and vulnerable population (Jawad et al., 2018).

As fuel products constituted the biggest part of the budget for subsidies, the newly elected government of 2011 manged to raise the price of liquid fuel in 2012 – **after many years of hesitancy.** In addition, prices of such products were indexed to global market prices from 2013 onwards. In a number of strategic notes, as well as co-hosted conferences and study visits with Moroccan governments, the World Bank has advised that the system of subsidies should be phased out and replaced by better-targeted programmes for the poor (Jawad et al., 2018).

Social Programmes to Ease the Adverse Effects of Reforms

Morocco has launched a number of large-scale, targeted social assistance programmes aimed at alleviating poverty and the negative effects of subsidies reforms. For example, the National Initiative for Human Development sets a geographical target for poverty and social exclusion. In

2013 alone, the National Human Development Initiative carried out 4583 projects and 1644 activities, i.e. 6227 interventions, with an expenditure of more than 3.9 billion Dirham (about USD 405 million, current prices). The total number of benefactors crossed 1.2 million (Jawad et al., 2018).

Lessons from Key Success Factors

The reform of the subsidies system was examined by Chen et al. (2014), who articulated the political economy model in Morocco and how **various factors helped decision-makers to successfully implement the subsidies reforms**:

- The public have multiplied their pressure on the government to widen the inclusiveness of the political economy system, together with increasing demand for accountability, transparency and economic opportunities.
- An incremental shift in executive power (i.e. away from King Mohamed VI to the Prime Minister) culminated in the 2011 constitutional reform, where, for instance, many senior official appointments have been moved from the monarchy to the head of government.
- The constitutional reforms introduced in Morocco in 2011 and their subsequent implementation have changed the old alliances between 'privileged businessmen' and the government. These factors have made it hard to reform subsidies in the past.

Therefore, the change in the old Moroccan political structure (i.e. following the constitutional reform) has made it easy to successfully pass subsidy reforms.

4.5 Yemen

Gains from Reform

- In their simulation of subsidy reforms in Yemen, Breisinger and Ecker (2012) noted that **the government can gain a significant saving from the removal of subsidies**. They estimated that the removal of subsidies at once could decrease the fiscal space from 6.9 % of GDP in 2009 to 3.5 % in 2011, which generates a surplus of 215 billion YER. They noted that the overall savings from an incremental or gradual reform are smaller (e.g. 130 billion YER from 2011 through 2013) than from an accelerated reform (e.g. one-time removal of subsidies).
- Breisinger and Ecker (2012) also showed that a **rapid (e.g. one-time) phasing-out of fuel subsidies in Yemen leads to an initial drop in growth and a sharper increase in poverty, while gradual reductions ease the effects of growth and poverty. Slow phase-out is thus preferable from the point of view of growth and poverty reduction.** Growth shocks (i.e. in a gradual reform) are less pronounced, especially in the agricultural sector, and overall household income losses are about 20% lower – compared to an accelerated reform. Nevertheless, **slow reform comes at higher fiscal costs, since subsidies need to be financed effectively over a period of several years.**

Description of Subsidies and Reforms

Yemen has implemented a number of measures to reduce fuel subsidies since the 1990s. The scale of these subsidies has varied over time, mirroring changes in international fuel prices, consumption volumes, exchange rates and domestic prices. Yemen's primary objective in the subsidy reform was to enhance its fiscal position–while paying due attention to social considerations. Despite these reforms, the budget subsidy bill remained big at around 10 % of GDP in 2012 (up 14 % of GDP in 2008). This level surpasses the total spending on infrastructure and social services (Ostojic, 2013).

The most essential subsidy reform, initiated in 2005, was aimed at progressively adjusting domestic prices over the medium term. This reform was based on World Bank and IMF policy advice, which highlighted the need to maintain fiscal sustainability in the face of shrinking oil reserves. As a consequence, the government increased domestic prices by 130% on average in July 2005. This increase in price led to mass protests, and the government responded by overturning it in part. However, the net price adjustment remained substantial at 71 % for gasoline, 106 % for diesel, 119 % for kerosene and 7 % for LPG. There was no increase in the price of diesel fuel, which is mainly used for the generation of electricity. The initial **relative success of fuel price adjustments was partially offset by an increase in commodity prices** in later years. Accordingly, the subsidy bill stayed high at almost 9% of GDP in 2005. However, it is worth noting that the social tensions during this episode were linked not only to the reform of the subsidies, but also to the reform of the tax system. (Ostojic, 2013).

As component of the reforms supported by the IMF's Extended Credit Facility in 2010, the prices of gasoline, diesel and kerosene were slowly increased by an average of around 30% and the price of LPG was doubled over a period of nine months. **The reform strategy was centred on technical assistance from the World Bank, which managed to learn from the observation of previous reforms.** Nevertheless, the public information campaign element of the strategy has not been introduced. Alternatively, the government has introduced small, surprising increases. In addition to the increase in fuel prices, the government has also implemented some efficiency-promoting measures, such as replacing diesel-powered generators with gas-fuelled ones. At the end of 2010, Yemen began to differentiate diesel prices by charging higher prices to commercial users. The primary objective of this reform instalment was to decrease fiscal pressures, following the record high fiscal deficit of 10% of GDP in 2009 (Ostojic, 2013).

In 2011/12, because of the **political crisis and tight fiscal space, the government increased the price of gasoline by 66% and doubled the prices of diesel and kerosene**. Overall, this reform episode was accepted by the population despite the political tension between the ruling party and the opposition. The major pipeline that provides oil to domestic refineries had been sabotaged. At the same time, the government was able to import only limited quantities of refined fuel products. The ensuing fuel scarcity resulted in the emergence of a black market, with prices that were a multiple of the official sale prices, and long lines at the gas stations. This situation may have played a role in the population’s acceptance of the official price increases in exchange for the benefit of uninterrupted supply (Ostojic, 2013).

Social Programmes to Ease the Adverse Effects of Reforms

In order to mitigate the impact of past subsidies reforms on the poor, the authorities have implemented or strengthened the following components of the social safety nets:

- **The Social Welfare Fund was created as a poverty alleviation programme in 1996 to offer conditional cash transfers to households.** The Fund's coverage has been gradually extended and transfers have been increased in stages. Transfers were partly intended to mitigate the impact of fuel subsidies reforms. The timeliness of the implementation of measures concerning social support varied. For instance, in the 2005 subsidy reform period, it took three years to approve the Social Protection Act to make it easier to apply for benefits and to increase monthly transfers. Conversely, the 2010 reform was almost simultaneously alleviated by a 50% increase in the coverage of the cash transfer scheme. To date, there have been no mitigation measures in the 2011/12 reform episode, but the government is planning a further boost in the coverage of the Social Welfare Fund or the size of existing transfers (Ostojic, 2013).
- Apart from **conditional cash transfers**, Yemen has two other programmes concentrating mainly on poverty alleviation. The **Public Works Project** offers short-term employment and backing for small-scale contractors via a labour-intensive public works programme. Furthermore, the **Social Fund for Development** encourages community and small- and microenterprise- development and offers short-term employment for both the transitory and chronically poor. Other mitigating initiatives include **change from more to less expensive fuels**. For instance, the **government** encouraged the conversion from kerosene to LPG for residential use as from the beginning of the 2000s. In 2010, diesel-fuelled power plants were also converted to natural gas (Ostojic, 2013).

Lessons from Key Success Factors

Cash transfers and other social protection programmes, if well designed and implemented in a timely manner, can be effective in protecting the poor and in reducing the resistance to reforms. The process of subsidy reform in Yemen has shown that adequate planning to strengthen the safety net and provide assurance on mitigation efforts is essential in order to win public support for the reform. Cash transfers from the Social Welfare Fund, as well as support from the Public Works Project and the Social Fund for Development, have helped to lower the opposition to reforms. On the basis of this experience, it can be argued that the dissent to the 2005 reforms could have been lowered if the social protection programmes had been introduced simultaneously (Ostojic, 2013).

Whereas adverse economic conditions raise the need for reforms, they may make price adjustments more complicated, especially if they are combined with political tensions. Therefore, it is essential, whenever possible, to incorporate reforms in a timely manner before economic and social conditions continue to worsen. The large resources used in generalised subsidies can then be used more effectively to target the poor and to stimulate growth and job creation (Ostojic, 2013).

Experience with the pace and size of price hikes has varied. Yet, **when the public was made aware about the need for and the advantages of the reforms (for instance, to ensure adequate supply) it supported a large price increase** (Ostojic, 2013).[2]

[2] When changes (such as price increases) were not followed by the implementation of an effective public information policy, especially in times of heightened political tension, widespread protests have forced the partial reversal of adjustments (Ostojic, 2013).

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