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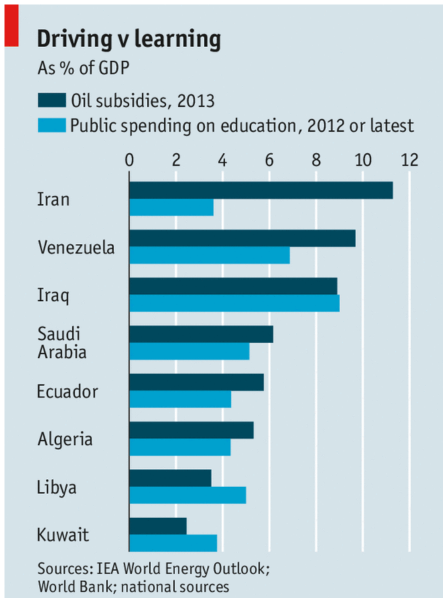
A few countries are taking advantage of lower oil prices to cut subsidies

Jan 17th 2015 | From the print edition



ECONOMISTS loathe energy subsidies. They wreck government budgets—Venezuela's parlous finances are partly the result of letting citizens buy petrol for a few cents a gallon. Subsidies damage the planet: they were responsible for 36% of global carbon emissions between 1980 and 2010. Despite noble intentions they do little to help the poor, since richer folk are heavier energy consumers. In 2008 the poorest 40% of Egyptians received 3% of petrol subsidies. So many economists will be heartened to see that some countries, notably Indonesia, are winding down such subsidy support, in response to the 50% fall in oil prices over the past six months.

Especially in non-democratic states, subsidies are seen as crucial to maintaining social stability. But as energy prices rose during the 2000s, so did the cost of the handouts. The value of fossil-fuel subsidies around the world increased by 60% from 2007 to 2013, eventually reaching $550 billion, according to the International Energy Agency. In many countries, they overshadow spending on health care or education.

A few poorer governments could not sustain such largesse, and so cut subsidies in spite of high prices. Kerosene prices in Yemen doubled in just one year, between 2011 and 2012. In 2012 Jordan eliminated fuel subsidies altogether. But many governments deemed it too risky to expose their citizens to the full heat of the energy market.

Now prices are tumbling, it is easier (and less inflationary) to cut subsidies: the difference between the free-market price and the one expected by citizens has shrunk. Egypt's government has slashed subsidies on diesel and petrol, which were worth 10% of GDP in 2012. In July it raised diesel prices by 64% and petrol by 60%. This month Indonesia scrapped petrol subsidies entirely. India has stopped controlling diesel prices.

In oil-exporting countries, which are particularly generous (the Middle East and north Africa account for half of the world's energy subsidies), people are more likely to accept budget cutbacks because the economy as a whole is struggling with lower prices, says Jim Krane of Rice University. However,

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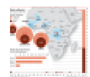
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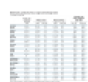
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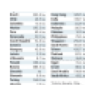
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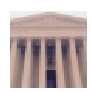
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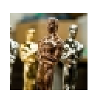
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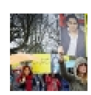
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lower energy prices make subsidies cheaper. That can make it tempting to postpone hard decisions. Of the 19 oil exporters tracked by Mr Krane, only a handful started to cut subsidies in 2014.

As a condition for granting war-torn Ukraine financial support, the International Monetary Fund (IMF) wants it to raise the price of domestic gas. Doing so will help to close the massive deficit of Naftogaz, the state gas monopoly, which for years has supplied Ukrainian households at a fifth of the price it pays for gas.

To quell dissent, some governments are offsetting price rises by helping the neediest. Jordan, which is increasing electricity prices, has pledged to start giving poor families stipends when oil prices next top $100 a barrel. In Yemen, where subsidies for diesel and petrol have been shrinking for years, the government is boosting the number of families eligible for help from its Social Welfare Fund.

Yet even in countries where reform has taken place, it has been done imperfectly. The most effective way to cut subsidies is to adopt a clear and automatic formula, cutting meddling politicians out of the process. Last year, for instance, Tunisia embarked on a gradual but predetermined series of price hikes for petrol intended to raise domestic prices to market levels. Typically, though, politicians are all too happy to respond to political pressure.

Some countries have done nothing at all. Chief among the laggards is Russia, where in 2013 energy subsidies for gas and electricity cost $40 billion. According to James Henderson of the Oxford Energy Institute, residential and industrial gas prices were frozen during 2014 and are unlikely to change this year. Raising them would dent the popularity of President Vladimir Putin at a perilous juncture.

Cutting consumption subsidies may seem sensible when prices are falling, but it is also the time when struggling energy firms turn to the state for help. As it is, governments in the G20 spend $88 billion each year supporting fossil-fuel exploration, according to the Overseas Development Institute, a think-tank. That figure may grow. In December George Osborne, Britain's finance minister, announced tax cuts on oil firms in order to support the oil-and-gas industry in the North Sea. The same month Mr Putin bailed out Rosneft, a big oil company suffering from the depreciation of the rouble. America is another big offender, with generous subsidies for exploration and production of oil and gas. There is little talk of trimming them. Whether low prices help to galvanise reform or simply make it easier for governments to procrastinate still remains up in the air.

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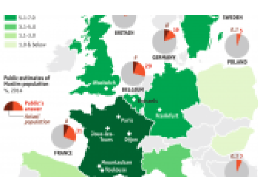

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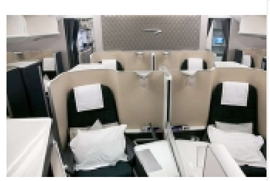

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