# Energy-subsidy reform can be achieved with proper preparation, outside pressure

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Reform of energy subsidies in oil-exporting countries can reduce carbon emissions and add years to oil exports, according to a new paper from Rice University's Baker Institute for Public Policy.

"Navigating the Perils of Energy-Subsidy Reform in Exporting Countries" was authored by Jim Krane, the Wallace S. Wilson Fellow for Energy Studies at the Baker Institute, who specializes in energy geopolitics. The paper reviews the record of energy-subsidy reforms and argues that big exporters should reduce energy demand by raising prices, and that this can be done without undermining legitimacy of governments that depend on subsidies for political support.

"Removing state subsidies on energy is one of the most politically dangerous acts there is," Krane said. "No government in the world wants to antagonize motorists or raise electricity prices. But previous experience shows that with proper preparation, subsidies can be rolled back without undermining government legitimacy, even in autocracies that use these discounts to preserve popular support."

Whether sold as bulk crude oil and natural gas or as retail electricity, gasoline or diesel, the major exporters of OPEC, Russia and others harbor some of the lowest domestic energy prices in the world. These fossil-fuel subsidies have allowed these countries to distribute resource revenue, bolstering legitimacy for governments, many of which are not democratically elected, Krane said.

"However, subsidy benefits are dwarfed by the harmful consequences of encouraging uneconomic use of energy," Krane said. "These effects include wasted resources, foregone revenue and outsized emissions of carbon dioxide as well as local pollutants such as sulfur oxides and nitrogen oxides. Now, with consumption posing a threat to long-term exports, governments face a heightened need to raise prices that have come to be viewed as entitlements."

Subsidy reform by centralized governments like those in most OPEC countries is even more difficult, since concentration of authority also concentrates the accountability of the head of state. Blame is difficult to evade – unless the leadership can blame outside pressure.

"A vociferous international outcry or pressure from a foreign government or non-governmental organization can provide political cover for governments to enact unpopular measures," he said. "Lobbying by external pressure groups is useful in this sense."

Perhaps the biggest risk implied by reforms of subsidies and social contracts is the possibility of unrest and even the overthrow of governments, Krane said.

Despite the risk, energy subsidies are not untouchable. According to the International Monetary Fund (IMF), all but five of 28 substantial attempts to dismantle subsidies over the past two decades met with some success. The list of reformers includes energy exporters. Indonesia, for example, after failed attempts in 1997 and 2003, successfully raised fuel prices in 2005 and 2008.

Krane said the most encouraging example of reform efforts is that of Iran, the first country in the world to replace major subsidies with a universal cash transfer program for households. Iran's 2010 reform was welcomed by the IMF and, at least initially, by the Iranian public, while halving the world's largest energy-subsidy burden, valued at around $100 billion or a quarter of the 2010 gross domestic product.

Done properly, ending subsidies can add years to the longevity of exports, while keeping global markets supplied and reducing both local pollution and carbon dioxide emissions, Krane said. Mismanaged, eliminating "entitlements" can undermine government legitimacy and trigger unrest. "In the Middle East, where pan-Arab revolts have toppled four governments and left a fifth in civil war, caution remains acute," he said.

Keeping prices low offers a short-term benefit, but in the longer run, giveaways of chief export commodities undermines exports, which invites greater economic and political trouble. Oil exporting regimes depend on export revenues to maintain control.

"Policymakers in exporting states understand that reforming subsidies is their best strategy for preserving political power, since export revenues are a key resource for political stability," Krane concluded. "Thus, constructive external criticism can provide regimes with persuasive tools for swaying public opinion of the need for higher prices and reduced demand."

**More information:** Paper: bakerinstitute.org/research/na … exporting-countries/

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