

## BOX 4.1 Reforms after the 2014-16 oil price plunge

*The 2014-16 oil price plunge triggered significant reforms. In energy exporters, the main focus was on encouraging diversification and putting public finances on a sounder footing. Both energy exporters and importers cut energy subsidies. Current low oil prices may provide a window of opportunity to put in place mechanisms that permanently eliminate energy subsidies.*

The 2014-16 oil price plunge forced many energy exporters into procyclical fiscal tightening that deepened their downturns. Many energy exporters recognized an urgent need to render both their economies and their public finances more resilient, and embarked on reforms to encourage diversification, strengthen non-oil revenues, and cut poorly targeted subsidies (Stocker et al. 2018; Figure 4.1.1). Energy-importing EMDEs also seized the opportunity of low oil prices to cut energy subsidies. This box examines these reforms in greater detail, answering the following two questions:

- Which reforms did EMDE energy exporters embark on?
- Which reforms did EMDE energy importers embark on?

### Reforms in energy exporters

Energy exporters initiated economic diversification programs, energy subsidy reforms, and measures to strengthen non-energy government revenues.

**Diversification programs.** Before the current plunge in oil prices, hydrocarbon sector activity represented more than one-third of GDP in a number of countries in Central Asia, Sub-Saharan Africa, and, in particular, the Middle East. Oil production represented the majority of government revenue and exports in most energy-exporting EMDEs in 2013. This suggests an untapped potential for greater diversification of exports and government revenues, which would bolster long-term growth prospects and improve these economies' resilience to external shocks (Hesse 2008; IMF 2016; Lederman and Maloney 2007).

Following the 2014-16 oil price collapse, several large energy-exporting EMDEs laid out medium- to long-term plans to reduce their reliance on the energy sector. As part of Saudi Arabia's 2016 Vision 2030 plan, the National Transformation Program targeted an increase in non-oil commodity exports and non-oil government revenues (Kingdom of Saudi Arabia 2016; World Bank 2016c).

Saudi Arabia's fiscal non-oil revenues improved from 7.7 percent of GDP in 2016 to 10 percent of GDP in 2019. Nigeria identified several sectors to promote greater diversification of export earnings and government revenues (Nigeria Ministry of Budget and National Planning 2017). Kazakhstan's "100 Concrete Steps" program, adopted in 2015, aimed to diversify the economy and improve competitiveness and transparency. By the start of 2020, Kazakhstan has completed more than half of these 100 steps, including efforts to improve governance. However, efforts to boost industrialization have encountered challenges, while plans to increase private land ownership have been delayed.

Efforts to encourage diversification have continued and include: reducing labor market rigidities (for example, Saudi Arabia, Oman, Qatar), supporting foreign and private investment (for example, Saudi Arabia), expanding infrastructure investment (for example, Malaysia), improving the business environment (for example, Algeria, Brunei Darussalam, the GCC countries, Kazakhstan, Nigeria, Russia), expanding deeper trade integration within the Eurasian Economic Union (for example, Russia), and strategic investment plans in renewables energy (Azerbaijan, the GCC countries). However, in some cases, the structural reform agenda has faced legislative or implementation delays (for example, Algeria, Kazakhstan).

**Energy subsidy reform.** The sharp reduction in government revenues among energy-exporting EMDEs led to an increased emphasis on reducing energy subsidies to restore fiscal space, discourage wasteful energy consumption, and reallocate spending to programs that better target the poor (IMF 2017b). Between mid-2014 and end-2016, more than half of energy-exporting EMDEs reformed energy subsidies, including countries in the Middle East and North Africa, Sub-Saharan Africa, East Asia, Latin America, and Central Asia.<sup>1</sup> A number of energy exporters have also reduced utility subsidies

<sup>1</sup> Energy subsidies were reformed between mid-2014 and late 2017 in Algeria, Bahrain, Cameroon, Ecuador, Gabon, Ghana, the Islamic Republic of Iran, Iraq, Kazakhstan, Kuwait, Malaysia, Nigeria, Oman, Qatar, Saudi Arabia, Sudan, Trinidad and Tobago, Turkmenistan, the United Arab Emirates, and Yemen. Reforms in Angola, Indonesia, and Nigeria, were, however, not sustained once oil prices rose.

Note: This box was prepared by Collette Mari Wheeler, with research assistance from Kaltrina Temaj.

### BOX 4.1 Reforms after the 2014-16 oil price plunge (*continued*)

although, during the COVID-19 pandemic, subsidies were raised again in some countries (for example, Gabon, Indonesia, Oman, Saudi Arabia, United Arab Emirates).

In some cases, subsidy reform was a significant break from past policy (Krane and Hung 2016; World Bank 2017b). Encouragingly, the design and implementation of recent energy subsidy reforms have been superior to past efforts, which were poorly phased and hampered by insufficient communication to the public about the rationale for reform (Asamoah, Hanedar, and Shang 2017; Clements et al. 2013). In many cases, recent reforms have also helpfully included measures to mitigate the impact on the poor and to strengthen social safety nets (for example, Algeria, Angola, Saudi Arabia). More recently, Nigeria announced plans to eliminate energy subsidies. However, revenue-enhancing energy price reforms have remained absent in some countries (for example, Cameroon).

**Fiscal reforms.** Several countries have implemented tax reforms to compensate for the loss of government revenues and to insulate themselves from future oil price fluctuations (World Bank 2018c). This has included the introduction of taxes on goods and services or value-added taxes (for example, Bahrain, Malaysia, Saudi Arabia, the United Arab Emirates), as well as raising existing VAT or excise tax rates (Bahrain, Colombia, Oman, Saudi Arabia, United Arab Emirates). Russia has implemented a fiscal rule that targets a primary deficit of 0.5 percent of GDP at the benchmark oil price of \$40 per barrel (in 2017 U.S. dollars). Any excess fiscal resources that are generated from higher oil prices are saved in the National Welfare Fund. The assets from this fund have already helped Russia support its economy and extend benefits to vulnerable households during the recent pandemic. However implementation of fiscal reforms has stalled in some cases (for example, Kuwait, Oman, Qatar), while exemptions have limited revenue growth in some others (Malaysia).

#### Reforms in energy importers

**Energy subsidy reform.** Like energy-exporting EMDEs, energy-importing EMDEs took advantage of declining oil prices to begin dismantling energy subsidies, which tend to disproportionately benefit those with higher incomes. In addition, they can crowd out public investment and encourage more intensive use of fossil fuels (Arze del Granado, Coady, and Gillingham 2012). Several countries have implemented such reforms in response to the 2014-16 oil price plunge (for example, China, the Arab Republic of Egypt, Mexico, Morocco, Tunisia), but slippages in implementation have occurred in some cases (for example,

Egypt, Mexico).<sup>2</sup> In response to the COVID-19 pandemic, some governments have provided fuel price discounts to some sectors (for example, Egypt) or increased subsidies to vulnerable households (for example, Guatemala, Montenegro, Ukraine).

**Other reforms.** Other reforms have aimed to raise revenues, with some countries increasing taxes on energy or energy-dependent sectors such as transportation (for example, Bangladesh, China, Egypt, Mozambique, Rwanda, South Africa, Vietnam; IEA 2015; IMF 2016; Kojima 2016). These steps also included measures to avoid energy subsidies reemerging if oil prices rebound—automatic pricing mechanisms or full energy price liberalization have been common (for example, China, Côte d'Ivoire, India, Jordan, Madagascar, Mozambique, Mexico, Thailand, Ukraine; Asamoah, Hanedar, and Shang 2017; Beylis and Cunha 2017).<sup>3</sup>

#### Conclusion

**Remaining challenges.** Some of these policies have yet to bear fruit. Notwithstanding fiscal and energy subsidy reforms in energy exporters, fiscal break-even prices—the oil prices at which government budgets are balanced—in almost all energy-exporting EMDEs exceed current prices, often by considerable margins. Energy subsidies still represented an average of 4 percent of GDP as of 2018 among energy-exporting EMDEs, many of which implemented reforms 2014-16 (Figure 4.1.1). In 2019, the share of commodity exports in total goods exports remained as high now as in 2013, before the last oil price plunge. The recent oil price plunge may provide further momentum to proceed with planned reforms and deepen them once the immediate health crisis subsides. Energy importers, in contrast, should take advantage of lower energy prices to lower subsidies—which averaged over 2.5 percent of GDP in 2018—and utilize these resources to finance urgent health care needs. In energy exporters and importers alike, there is an opportunity to put in place reforms now that are non-binding in the short term but address long-standing inefficiencies and fiscal costs in the long term.

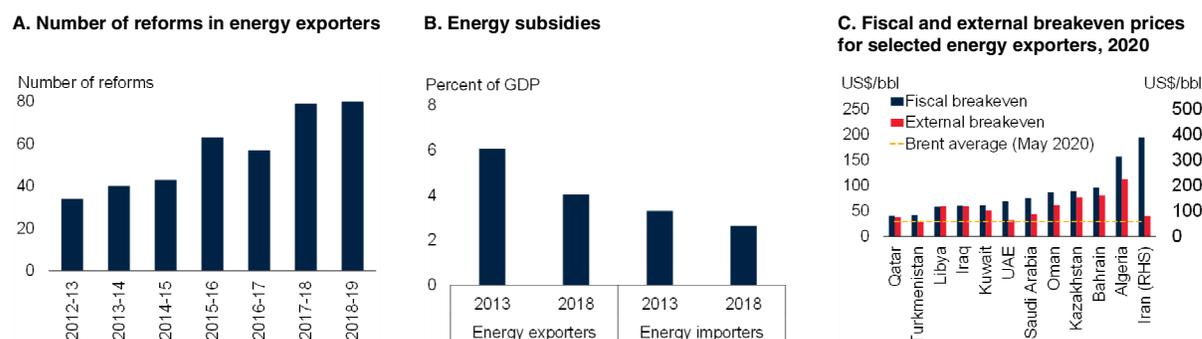
<sup>2</sup> Mexico has a diversified export base and, hence, is classified as an energy importer.

<sup>3</sup> In Mozambique, the elimination of fuel subsidies, the introduction of an automatic fuel price adjustment, and increased tariffs on electricity and public transportation, contributed to the 2 percentage points of GDP narrowing of the primary fiscal balance between 2016 and 2018.

## BOX 4.1 Reforms after the 2014-16 oil price plunge (continued)

### FIGURE 4.1.1 Reforms since 2014

Energy exporters have implemented reforms to strengthen business climates and reduce energy subsidies, but current oil prices remain below fiscal and external break-even prices in most energy exporters.



Sources: International Energy Agency; International Monetary Fund; World Bank Doing Business.

A. Sample includes 35 energy-exporting EMDEs.

B. Sample includes 25 energy-exporting EMDEs and 14 energy-importing EMDEs.

C. Breakeven prices refer to the oil price at which either the fiscal balance or the current account balance is zero in 2020. Dashed line indicates the average of daily Brent oil prices from May 1, 2020, to May 20, 2020.

[Click here to download data and charts.](#)

**Fiscal space generated by subsidy reforms.** Replacing energy subsidies with expanded and better-targeted social safety nets, coupled with structural reforms, can improve fiscal positions while supporting low-income households.<sup>4</sup> Policies to reduce subsidies can help promote growth because fiscal savings generated by lower subsidies can fund productivity-enhancing education and infrastructure. For example, in Egypt, fiscal savings from the energy subsidy reforms were redirected towards social spending (ESMAP 2017b). These policies can also foster low-carbon transition and promote green energy (Monasterolo and Raberto 2019; Mundaca 2017). For energy-exporting EMDEs, eliminating costly energy subsidies could help offset the collapse in revenue from oil extraction given that oil prices are well below their fiscal breakeven points.

**Increasing the chances of success of subsidy reform.** Energy subsidy reform raises formidable political-economy challenges (Inchauste and Victor 2017). The different prongs of reforms, however, need to be carefully sequenced and communicated to avoid delays, social unrest or reversals, as has been the experience in some client countries (for example, Ecuador; Worley, Pasquier, and Canpolat 2018). Reforms may prove more lasting if a few principles are observed in their implementation.

<sup>4</sup>For details, see Coady et al. (2017, 2019); Guénette (2020); Stocker et al. (2018); and World Bank (2014, 2015a, 2015b).

- *Entrenching reform.* Reforms formally embedded in legislation may be more likely to be enforced and sustained once oil prices rise again.
- *Transparency.* Reforms are more likely to be sustained if price setting can be de-politicized (Inchauste and Victor 2017). This can be achieved with a transparent formula for setting energy prices.
- *Frequent price adjustments.* A formula with more frequent price adjustments can help avoid larger and more disruptive price changes, especially once oil prices return to more normal levels.
- *Tax design for price stability.* A transparent formula for frequent price adjustments can be accompanied by combination of fixed and variable taxes that can smooth price volatility, such as in the case of Chile.
- *Supporting reforms.* Subsidy cuts that are accompanied by cuts in the cost of other household public services, such as school or public transport fees, or increases in other social benefits can help build public support for reform. In India, for example, the removal of price controls was accompanied by targeted cash transfers and in Brazil by targeted assistance to low-income households for energy conservation (Deichmann and Zhang 2013). Such supporting reforms need to be accompanied by improved capacity to implement benefit programs (Inchauste and Victor 2017).

### BOX 4.1 Reforms after the 2014-16 oil price plunge (*continued*)

- *Public awareness.* Awareness campaign can highlight the benefits of subsidy reforms, in terms of giving greater room for higher-priority spending, and thus raise public support for reform (El-Katiri and Fattouh 2017).

#### Role of competition, legal and regulatory frameworks.

Improving the macroeconomic framework and competitive environment can be more effective in improving the financial positions of both consumers and producers than energy subsidies. Carefully designed and properly enforced antitrust laws and consumer protection legislation are essential components of institutional frameworks that support market mechanisms. A sound legal and regulatory framework favoring competitive markets provides a more effective response to many of the problems that subsidies attempt to address. For example, the removal of price controls and barriers to entry in the transportation sector significantly increased competition and lowered transportation costs in Rwanda (Teravaninthorn and Raballand 2009). Even in the case where incumbent firms maintained outsized market shares, the presence of

competition and the potential for new entrants significantly lowered their markups.

**Energy pricing reform.** Even in EMDEs where energy subsidies have been eliminated, the current low oil prices provide an opportunity to introduce carbon pricing and other energy taxation that will discourage inefficient consumption as global oil prices rise again. As a cost-effective instrument for meeting climate targets, 57 initiatives (including 28 emission trading systems) were implemented at the national and subnational level in 2019, covering about 20 percent of global green-house gas emissions (World Bank 2019a). Existing carbon pricing is considered insufficient to meet climate targets, so policymakers should seize the current opportunity of exceptionally low energy prices to put in place pricing formulas now that encourage more energy-efficient growth once the recovery gathers momentum (World Bank 2019a). Finally, support measures for energy-intensive industries during the current pandemic could be made contingent on improvements in fuel efficiency.

EMDEs—may outweigh benefits to activity in energy importers.<sup>15</sup> Adverse effects are likely to be compounded by new headwinds, including elevated macro-financial vulnerabilities that were less relevant in previous oil price plunges, or even a second wave of infections. That said, there might be a short window early in the recovery when still-high inventories depress prices and support activity.

**Implications of the demand-driven nature of oil price plunge.** In contrast to the oil price plunge of 2014-16, the 2020 episode has been mainly driven by a collapse in energy demand resulting from restrictions to stem the spread of the pandemic and the global recession (Figure 4.1). Once the global recovery is underway, and excess inventories are unwound, oil prices would be expected to increase again in tandem with global growth.

**Coincidence with other shocks.** The public health crisis, unprecedented capital outflows from EMDEs, and a collapse in global trade and tourism have put financial and economic pressures on energy exporters and importers alike (Figure 4.8).

- *Public health crisis.* The number of confirmed infections has soared in energy-exporting EMDEs, as well as energy-importing EMDEs, and the effect of the sharp loss in consumer and investor confidence may linger long after the pandemic has subsided.
- *Trade collapse.* Global manufacturing activity, tourism, and trade have plunged amid closures of non-essential services, shops, factories, and public spaces; stay-at-home orders travel restrictions; and a high degree of risk aversion of consumers (Chapter 1).
- *Tightening financial conditions.* Flight to safety has resulted in a sharp tightening of financial conditions in EMDEs (Chapter 1). Global equity markets have fallen sharply, with

<sup>15</sup>The 2014-16 oil price plunge is a reminder that this will also be a challenge, although to a lesser extent, in energy importing economies with sizable energy sectors.