Social Safety Nets and Energy Subsidy Reform: Tools for Practitioners

Ruslan Yemtsov
Amr Moubarak
Social Safety Nets Core Course,
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Outline

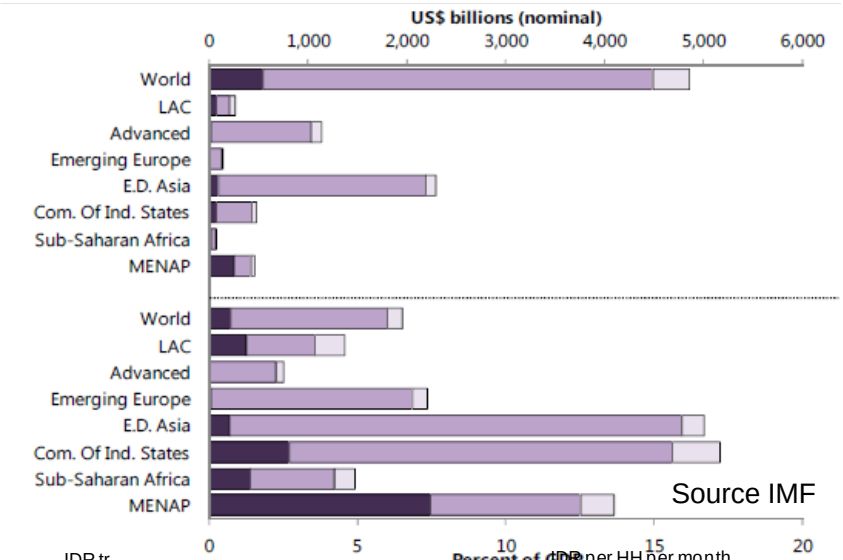
The role of social safety nets in the context of subsidy reform and beyond

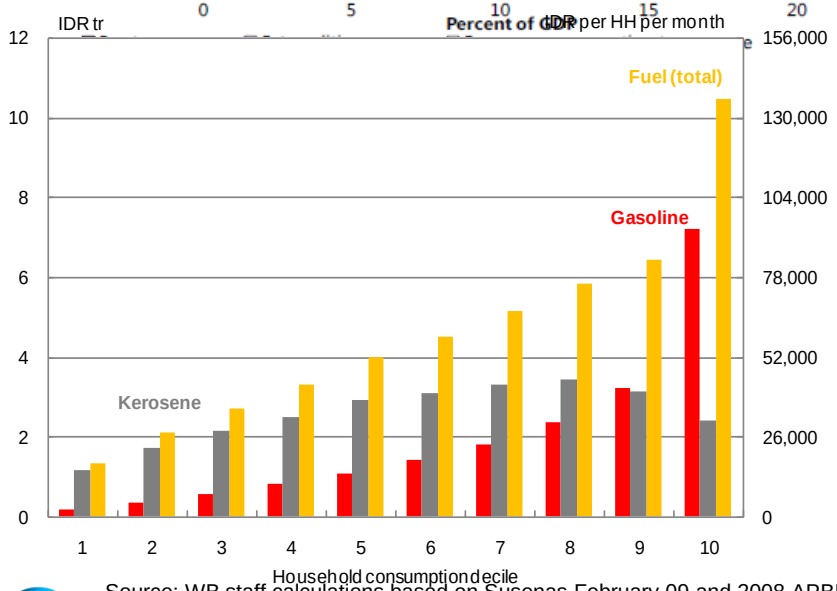
How countries have used subsidy reforms to expand and improve safety nets for the poor and vulnerable?

- Using fiscal space to support expansion of safety nets
- Using political space to support modernization of safety nets

What resources and tools are available to support SP practitioners involved in subsidy reform?

Why reform energy subsidies?





Source: WB staff calculations based on Susenas February 09 and 2008 APBN

- Global spending on energy subsidies amounted to $325 billion in 2015 and and $260 in 2016 (IEA)
- This is an immense fiscal burden (6.5 % of world GDP)
- It results in over use of fossil fuels
- Diversion of resources away from social goals: spending on subsidies exceeds social assistance spending in over 50 countries.
- Instead fossil fuel energy should be taxed, and the increases in prices needed to achieve that are significant (even with low oil prices)
- Subsidies are regressive

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Need for SSNs in the context of subsidy removal

The increase in the cost of living caused by knock-on effects of higher energy prices onto other prices can be substantial

- E.g. Results from PSIAs in Morocco the removal of petroleum subsidies would increase poverty by about 5 percentage points; and in Egypt by 4.5 percentage points (almost 3 million people).

The macroeconomic effects (including on inflation, employment and wages) caused by the shift in energy prices

- Even if poor are not consuming much of the energy products, the ripple effect can be significant (additional 4-5 percentage points inflation)

Economic rationale: The poor and near poor need to be protected otherwise they could fall into the poverty trap.

- We need to avoid long term impacts of fuel price adjustment since the poor and near poor may cut health and education spending as a coping mechanism, undermining future prospects to escaping poverty.

Political rationale: The middle class obviously the losers in the short run. They usually use the poor as " a scape goat" to block the reform

- Well designed compensated package can be use as a counterargument and exclude this popular issue.

SSN can be used to mitigate the effects

- SSN are progressive, energy subsidy are regressive: the reform channeling subsidies to expanded safety nets results in better social welfare outcome and more equal distribution
- Scale of impact of subsidy removal on households is below typical SSN transfer generosity (10-20% of consumption for recipients)

=>SSN replacing the subsidy will improve welfare of the poor and the distribution

- Recipients of cash transfers can benefit immediately, even before the shock of price adjustments.
- Cash is easier for beneficiaries when making adjustments in their consumption needs.
- In terms of program implementation, giving cash is more efficient and the distribution costs are cheaper compared to in-kind forms or services.

Main challenge : inflexible SSN with low coverage and low adequacy

- Existing cash transfers have low coverage
- Existing information systems used by SSNs do not contain data on potential beneficiaries
- Most transfer schemes imply flat benefit amounts that do not reflect the actual (differentiated) effects of energy prices on different households
- Existing transfer schemes have inflexible eligibility determination mechanisms that do not allow rapid scale up
- There is overlap or lack of coordination across different programs and actors involved
- Existing programs do not have clear graduation strategy for beneficiaries through linkages to employment-creating fear of “dependency”

Several options to overcome the challenge:

It is possible to set up a new safety net cash transfer program filling gaps in a matter of months

- Indonesia BLT, Dominican republic, Ukraine HUS

It is possible to use the existing safety net, make it more flexible, adequate, accessible or consolidate programs

- Ukraine new HUS benefit, Armenia Family Poverty Benefit, Brazil Auxilio Gas/ Bolsa Familia

Sometimes it is possible to re-target the subsidies themselves, integrating it with SSNs, using of technological innovations

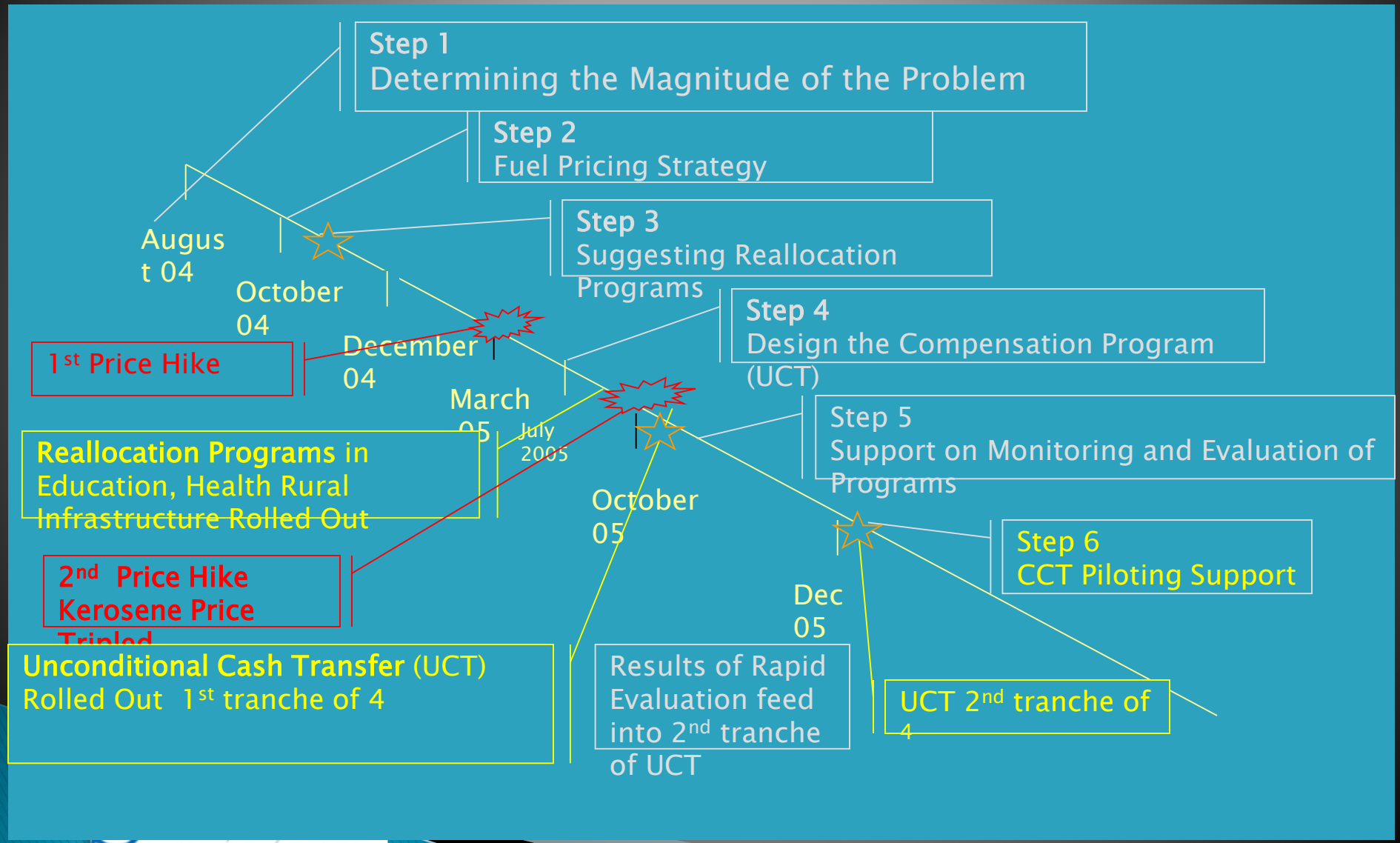
- Malaysia smart cards, Egypt smart cards

Systemic approach to SSN allows combining targeted pro-poor SSNs and measures aimed at "vulnerable"

- Improved, expanded and better targeted employment programs (Romania), or education (Dominican republic, Indonesia)

Indonesia village investment fund

Indonesia. Fastest timeline for reform and compensation package: Reform in 2005



Indonesia: Poverty impact and costs of compensation

- With proper mitigation and good targeting poverty increases can be prevented
- Cost of SSN compensations was a small part of the savings, but sufficient to protect the poor and vulnerable and ensure modernization of SSN
  - In 2005 – reduction of subsidies by 2 % of GDP, cost of compensations 0.8% of GDP, but only temporary cash transfer (over 4 quarters)
  - In 2008 – all subsidy reform savings have resulted in increasing SSN financing
  - In 2013: subsidy reform helped to save 0.4% of GDP , and the total compensation package amounted to 0.3% of GDP, but just 8% of this went to support expansion of SSN, the rest went to other social policy measures
  - 2014: new reform – and launch of new productive family programs consolidating 4 SSN schemes (health, stipends, financial services, microcredit and employment)

Year	% fuel price increase	Compensation (Rp/HH) 2005 price	Before	After (t+1)	(t+2)	(t+3)
2005	66 %	100	16.7	17.8	16.6	15.4
2008	30 %	114	15.4	14.1	13.3	12.5
2013	44 %	89	11.4	11.5	10.5	10.1

Indonesia: summary of steps to strengthen SSNs

- Introduced large temporary cash transfer program (BLT) covering one-third of households building on existing social safety net programs; it was used in 2005, 2008 and 2013. The program tested the use of smart cards introduced later in all SSNs.
- By 2012 it developed (after first attempt in 2005) a comprehensive register
- Introduced innovative CCT program (PKH) and expanded in to 3 mln HH (currently scaling it up to 6 mln currently and by 2018 to 12 mln)
- Is currently reforming inefficient food subsidy program (RASKIN) with the Smart card mechanism
- Reallocated some budgetary savings to education, health, and infrastructure programs benefitting broader population. Promoted education access by introducing stipend for poor students (BSM) and health by expansion of health insurance scheme (Jankesmas) to the poor.
- In 2014 introduced new social security scheme to ensure 100% coverage of the informal sector
- In 2014 launched a new Productive Family program.
- Initiated program to reduce kerosene use by increasing LPG use

Energy pricing reforms in Ukraine

- The Government significantly increased gas (450%) and heating (70%) tariffs for households as of April 1, 2015
- The Government simplified social assistance mechanisms in February and March, 2015
  - the Government consolidated various rebates on utilities for special groups and New Compensation Program with an expanded, simplified Housing and Utilities Subsidies (HUS) program; HUS administration was improved, and full retraining of 3000 welfare officers was conducted.
  - The main outcome of these reforms was a transformation of SSN from old-fashioned small programs serving fixed group of clients to modern flexible programs with clear business process and service standards, and change in interaction with citizens
- The Government approved Gas Sector Reform Implementation Plan on March 25, 2015; energy tariff increases, strengthening of social assistance mechanisms and nation-wide public information campaign on energy and subsidies reforms are essential parts of the Plan
  - The Plan was developed by the Ministry of Energy, Ministry of Social Protection, Energy Regulator (with inputs from the Ministry of Finance, Ministry of Regional Development, Antimonopoly Committee and Geological Service), together with the Bank team and in consultations with EC and Energy Community Secretariat
- Media coverage of the reform improved
  - In the regions where media training have been conducted, the quality of reporting on energy reforms improved; resulted coverage: ~14 million Ukrainian adults (>30% of population)

Gas and electricity prices reform in Dominican Republic

- The new Government elected in 2008 adopted a comprehensive reform strategy
  - *Both electricity and LPG subsidies were reformed, in the case of LPG both the HH and transport sector were included in compensation schemes*
- The Government used the momentum to build key building blocks of the modern SSN
  - Solidaridad, CCT scheme existed before the reform, but operated on a small scale. New registry , SIUBEN was compiled containing data on 60% of the household sin the country. SIUBEN was built base don the census, but quickly moved to an open on-demand registration procedure. It has started provided data for targeting 6 other SSN programs (in nutrition, food subsidies and education). The payment system in Solidaridad was using modern backoffice functions backed by Visa. Food subsidies moved also to the use of smart cards. There was a full coverage of the poor achieved, and complete compensation to the bottom 40%, resulting a a progressive change in the distribution.
- The reform of electricity subsidies was more difficult to implement.
  - The plan gradually replaced poorly targeted tariff rebates by the targeted subsidy using SIUBEN starting in 2009. Both were costly and ineffective - 1% of GDP
- Compensation to a powerful interest groups that opposed the reform (drivers using LPG) allowed the reform to become politically feasible

SSN modernization and improved efficiency in the context of reforms

Dominican republic: reform to LPG and electricity prices tied with building a registry and developing system of transfers (CCT and compensations), providing a package of support to households, focus on improving governance and robust procedures. Coverage of the poor increased from 5 percent to full coverage of all poor and vulnerable. Total savings from LPG subsidy removal were 0.5 of GDP. SSN measures accounted for 0.13% of GDP

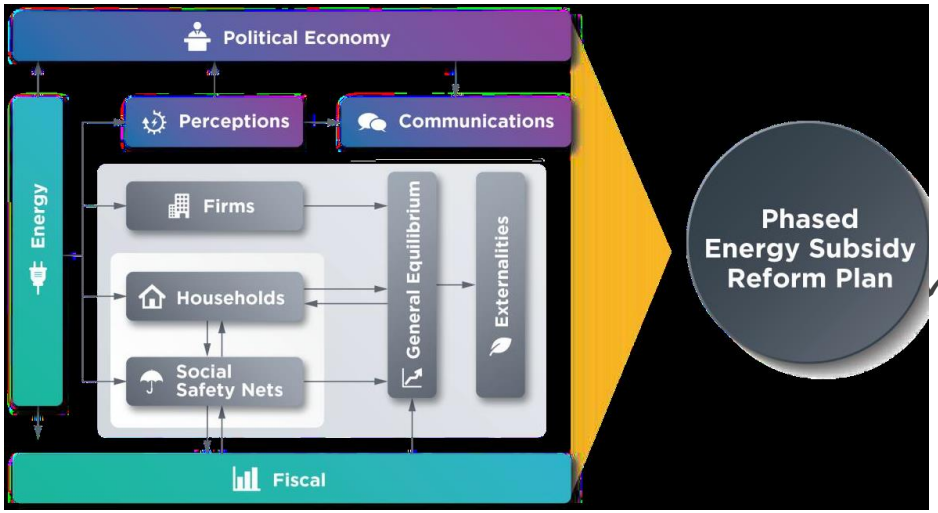
Ukraine: 400% hike in the price of gas and electricity tariff increases. Reform of the social assistance and housing subsidies. Dramatic simplification of administrative procedures (developed with SA Ministry and regional authorities), harmonization and unification of various small SSN schemes, reform of business processes, massive outreach campaign, adequate financing of the new safety nets, increase in coverage from 1/3 of all poor to over 60% of poor and vulnerable. Savings from reducing gas subsidies amounted to 4% of GDP. SSN modernization and expansion package resulted in expansion of spending on targeted SSN from 0.33% to 0.6% of GDP, and largely prevented increase in poverty.

Key Lessons from International Experience

- Phasing out subsidies and replacing them with direct transfers can work.
- The package of measures should go beyond price/compensation logic and develop strategy to invest in modern social safety nets.
- Readiness assessment to inform reform is an indispensable tool
- Road ahead: modern delivery systems.

ESMAP Goal

ASSIST GOVERNMENTS TO REDUCE ENERGY SUBSIDIES IN A SUSTAINABLE AND SOCIALLY RESPONSIBLE WAY



✓ **Facility co-led by the Energy and Extractives and Macroeconomics & Fiscal Management Global Practices**

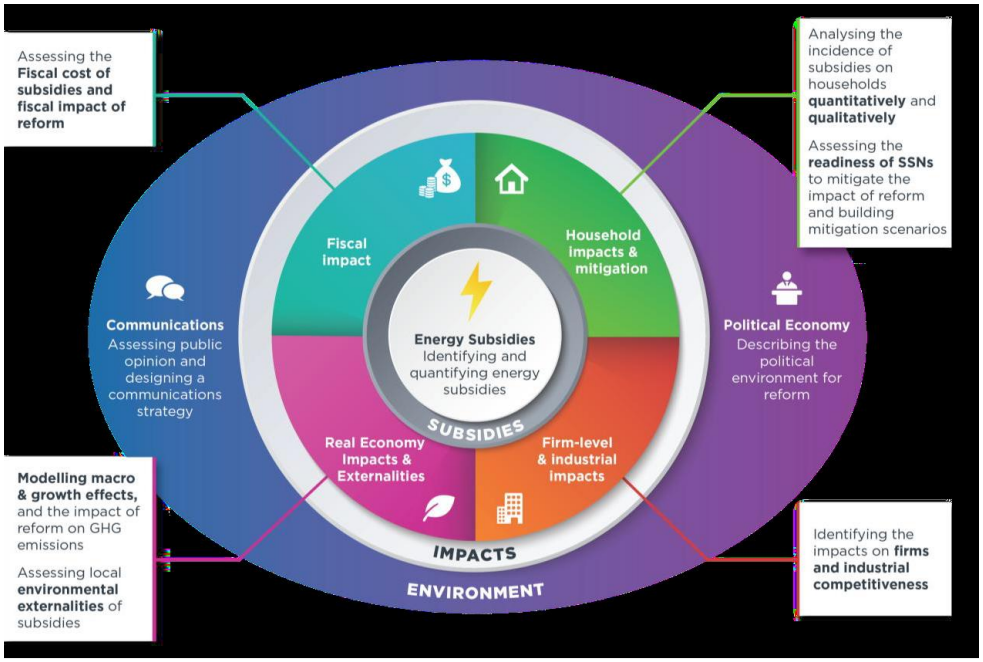
- **Involves staff from other Global Practices in program delivery**

✓ **Works through**

- **Analytics**
- **Technical Assistance**
- **Knowledge Sharing**
- **Global Advocacy**

Resource:

Energy Subsidy Reform Assessment Framework (ESRAF)



- **Diagnostic toolkit covering analytical methods, questionnaires, terms of reference, examples of past work.**
- **Comprehensive assessments answer a core set of policy-relevant questions that arise in the context of Energy Subsidy Reform**

1. **Identifying and estimating the value and fiscal cost of subsidies**
2. **Assessing the incidence of subsidies, and distributional impact of reform and compensation options**
3. **Modeling macroeconomic and growth effects and impacts on industrial competitiveness**
4. **Assessing local and global environmental externalities of subsidies**
5. **Political economy of reform and public communications**

Thank you!