Impact of Energy Subsidies on National Competitiveness

Reforming Subsidies for Electricity Markets in GCC

4th Roundtable Meeting for Power Trading

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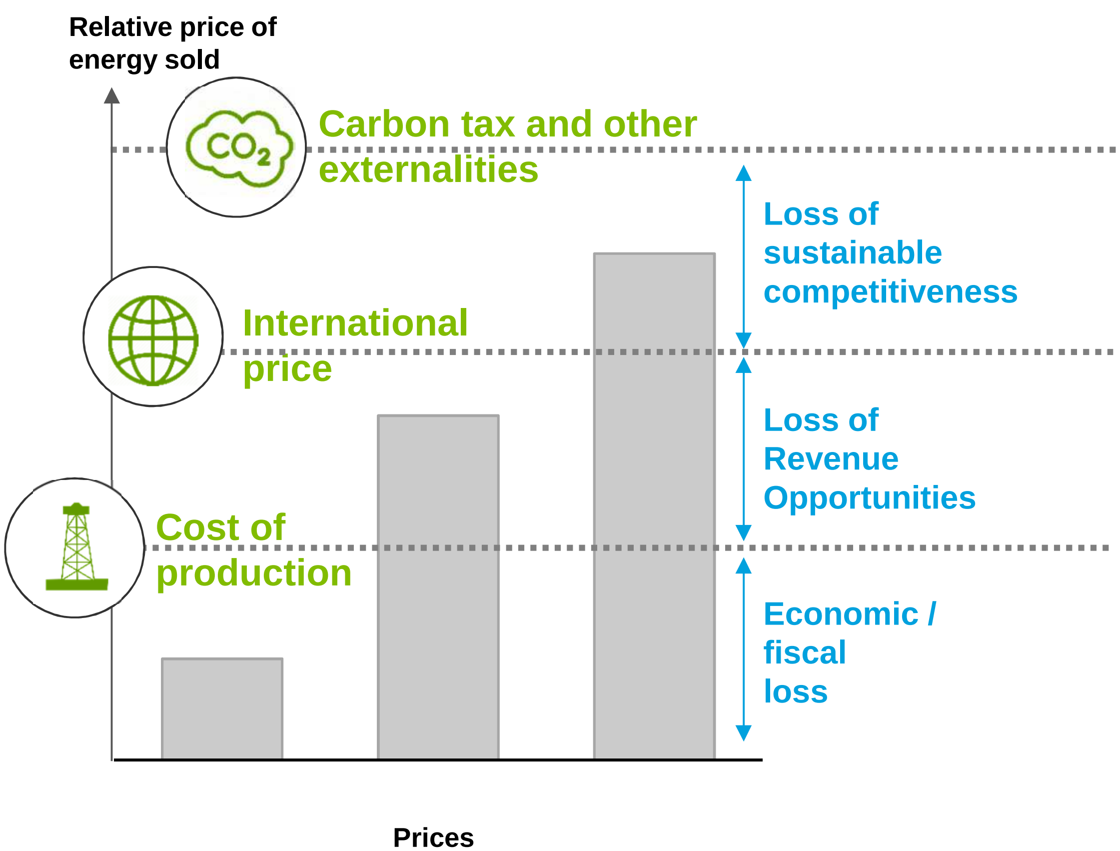
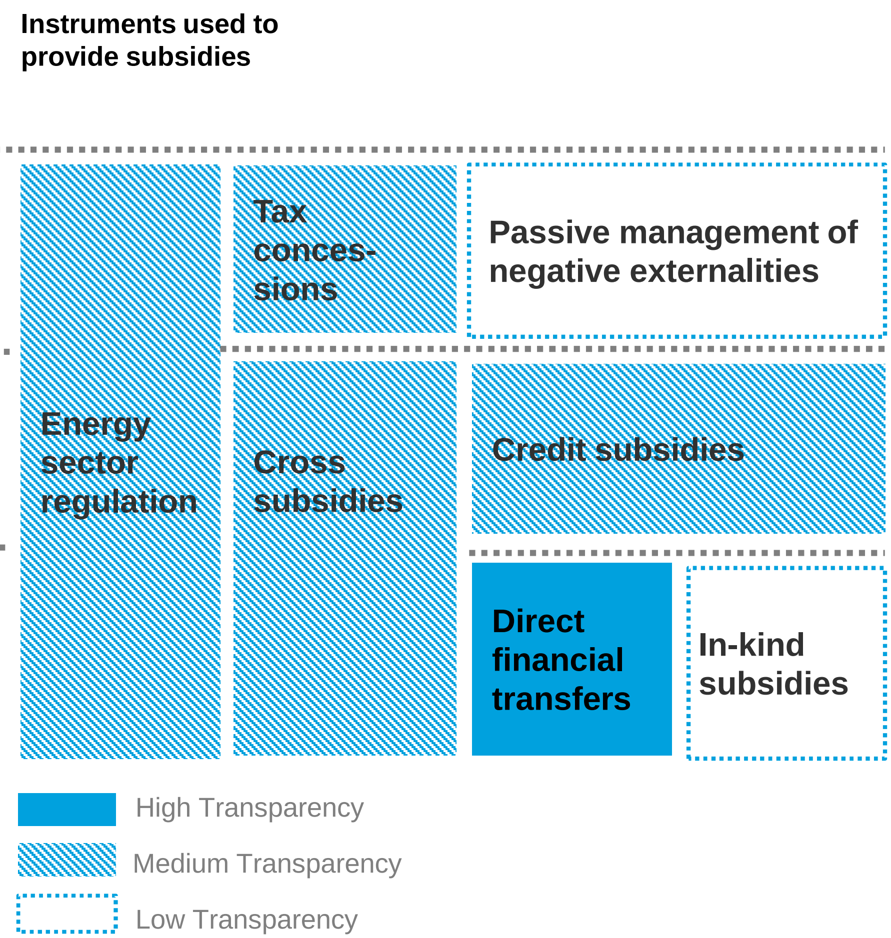
Abu Dhabi
December 2015

Efforts to understand energy subsidies are complicated by the difficulties associated with defining them in the first place

Subsidies can be defined by the type of price-driven costs incurred…



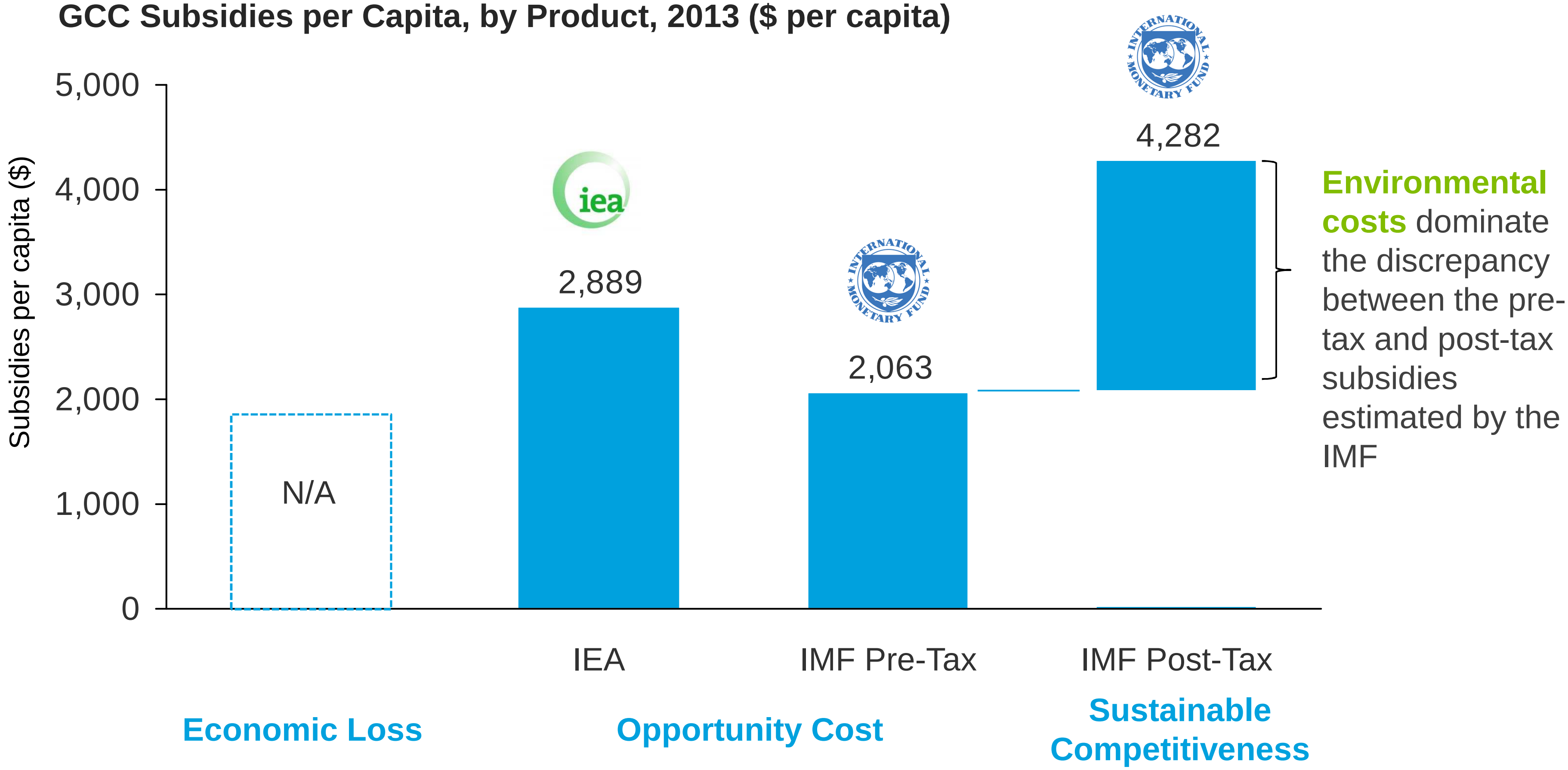
…and also by a wide range of implementation tools



Source: SGI; IMF; IEA; World Bank; Monitor Deloitte analysis

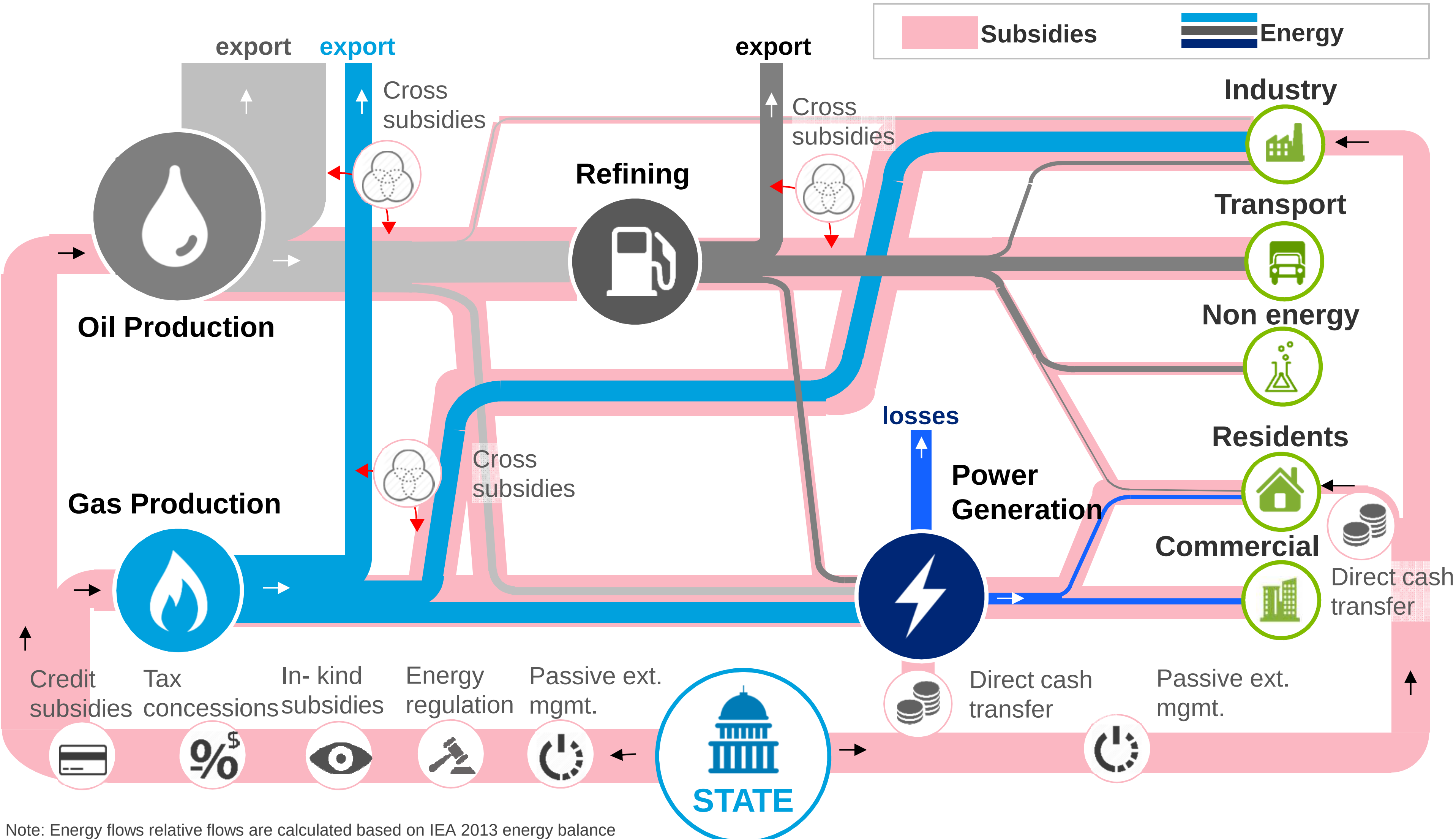
The greater the orientation of the economy towards global competitiveness, the larger the estimated energy subsidies

GCC Subsidies per Capita, by Product, 2013 ($ per capita)



Note: The IMF calculates energy subsidies as consumer price less supplier costs plus a tax reflecting environmental damage on top of a consumption tax
Source: IMF; IEA; World Bank; Monitor Deloitte analysis

Understanding subsidies is further complicated by the fact that distribution system does not always follow physical energy



Note: Energy flows relative flows are calculated based on IEA 2013 energy balance data for GCC states. Flow charts are simplified to exclude all single flows below 1 000 Mote. Subsidy flows are for illustration purposes only

Source: IMF; IEA; World Bank; Monitor Deloitte analysis

There are ways of untangling subsidies to elevate negative socio-economic implications

INITIAL RATIONALE

- **Avoid inflationary pressures**
- **Consumption smoothing**
- **Foster industrial development**
- **Protection of the poor from high energy prices**
- **Expand access to energy**

RISKS ASSOCIATED WITH "LIFITING" SUBSIDIES

Business/industry risks

- Temporary reduced international competiveness owing to higher prices

Macroeconomic risks

- Short-term negative consequences for GDP
- Short-term inflation
- Short-term price volatility

Social welfare risks

- Reduced household incomes
- Unemployment as firms go out of business
- Increased poverty levels
- Reduced access to energy

MITIGATION MECHANISMS

- Phased approach to allow industry time to adapt
- Extended and improved access to credit

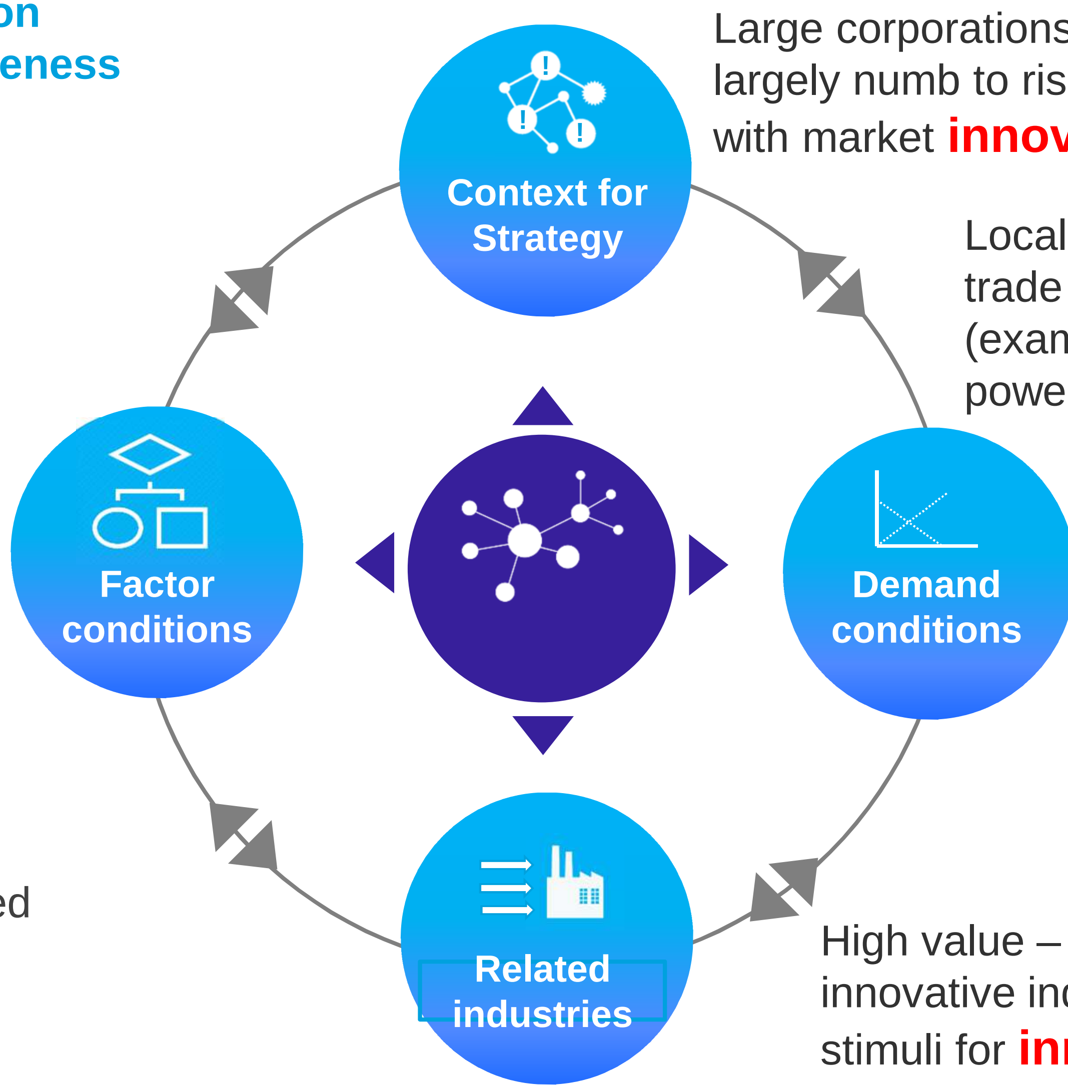
- Complementary monetary policy changes to deal with inflationary impacts

- Transfers: e.g. increase non-taxable income; introduce/increase minimum wage; cash transfers for vulnerable groups
- Infrastructure projects/investment in order to ensure access to electricity/fuel

Source: GSI; IEA; Monitor Deloitte analysis

In addition to hindering the efficient use of economic resources subsidies discourage progressive economic innovation

Effect of subsidies on strategic competitiveness factors in GCC



Large corporations become largely numb to risks associated with market **innovation**

Local competition and trade is discouraged (example – beneficial power trade)

Wasteful consumption of main strategic natural resources

Energy consumers are not provided with stimuli to purchase **innovative** products and services

Hazards negatively affecting population – strategic resource

Potential intellectual capital is not employed in **innovation**

High value – add, innovative industries lack stimuli for **innovation**

Source: GSI; IEA; Monitor Deloitte analysis

Conclusions

- Subsidies need to be simplified, multiple mechanisms and flows need to be analyzed to fully comprehend their strategic effect on GCC economies
- The passive management of negative externalities is arguably the most difficult implicit type of subsidy to quantify. Examples to this assertion include: not taxing environmentally damaging activities, not conserving energy in a sustainable manner and not considering energy security
- Risks associated with untangling subsidies can be mitigated. Key - clear communication with stakeholders, timing and targeted support
- In addition to fiscal reasons eliminating subsidies enhances national competitiveness
- Primary hindering factors of national competitiveness due to subsidization are loss of incentives to innovate and loss of strategic and competitive edge by subsidized industries

Statement for discussion

Looking at power trade in GCC as an instrument of reducing subsidies on a regional level, will allow us to develop innovative trading mechanisms. Trading "future benefits of lifting subsidies" in a form of electricity. Rather than waiting for reforms to happen.

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