COUNCIL *on* FOREIGN RELATIONS

POLICY INNOVATION MEMORANDUM NO. #47

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From: Isobel Coleman

Re: How to Make Fuel Subsidy Reform Succeed

Fossil fuel subsidies are a global scourge. They distort markets, strain government budgets, encourage overconsumption, foster corruption, and harm the environment while doing little to remedy inequality or stimulate development. Yet despite compelling arguments for reform, fossil fuel subsidies remain deeply entrenched. Citizens have yet to be convinced that fuel subsidies can and should be replaced with more efficient poverty alleviation programs. As a result, governments refrain from phasing out fuel subsidies for fear of triggering a public backlash, and even civil unrest. To bolster the prospects for subsidy reform, the United States should support the creation of a new public-private partnership within the World Bank, the Global Subsidy Elimination Campaign (GSEC), to work with governments to execute country-specific communication programs that would build the case for fossil fuel subsidy reform among citizens. The GSEC would start with pilot programs in select countries, and on the basis of these efforts, expand its work to other countries interested in fuel subsidy reform. If the GSEC helps generate just a 5 percent reduction in the more than half a trillion dollars that governments now spend on fossil fuel subsidies, it would free up billions of dollars for more effective anti-poverty initiatives.

SUBSIDIES UNDERMINE DEVELOPMENT

Fuel subsidies impose a particularly significant fiscal toll on developing countries. Uzbekistan, the world's heaviest fuel subsidizer, spends 25 percent of its gross domestic production (GDP) on fossil fuel subsidies, seven times more than on health and education combined. Fuel subsidies are particularly burdensome in the Middle East and North Africa (MENA) region, which accounts for half of all fuel subsidy spending. Yemen, for example, spends 6 percent of its GDP on fuel subsidies, more than its budget for much-needed infrastructure and social spending. Egypt spends over 10 percent of its GDP on fossil fuel subsidies, contributing significantly to the country's budget problems. Subsidies stretch limited state budgets in developing countries, inhibiting governments' abilities to invest in development and growth.

Fuel subsidies also inadequately address inequality. Touted as poverty-alleviation mechanisms, fuel subsidies primarily benefit middle- and upper-income groups. The richest 20 percent of households in low- and middle-income countries use six times more subsidized fuel than the poorest 20 percent.

WHY TECHNICAL EXPERTISE IS NOT ENOUGH

Some governments and international organizations have made fuel subsidy reform a priority. Yet, cases of failed attempts continue to outweigh success stories. One of the main barriers to reform is lack of public awareness about the costs of fuel subsidies. A 2012 World Bank study found that 70 percent of the population in Morocco did not know their fuel was subsidized. Without understanding how much their government spends to subsidize fuel, citizens are unlikely to agree to replace them with better alternatives such as cash transfers, which are widely recognized as far more efficient and effective at poverty alleviation. Instead, they will only see the elimination of a tangible good (lower-cost energy). The public needs to be convinced of the near-term benefit of more targeted income support for the poor and the longer-term benefit for all of additional government resources for productive investments. In Indonesia, Yemen, Egypt, and Nigeria, public resistance and mass protests at the prospect of subsidy removal have alarmed leaders and encouraged policymakers to abandon reform efforts. Without public support, leaders cannot implement the subsidy reforms they know are critical.

International organizations—the World Bank and International Monetary Fund (IMF) in particular—have impressive expertise on subsidy reform and have helped countries to evaluate existing subsidies and craft policies to shift to better alternatives. As the few success stories demonstrate, subsidy reform hinges on an effective communications strategy that builds domestic support by clearly articulating the goals and benefits of reform. Iran, which reformed its subsidy program in 2010, conducted a broad public relations campaign before the reforms took effect to explain their purpose, how people would be compensated for higher energy prices, and the benefits to the country. Ghana's efforts to phase out fuel subsidies were helped by commissioning and publicizing an independent assessment that showed poor people would benefit from the elimination of fuel subsidies.

GOING DIRECTLY TO THE PEOPLE

Although such success stories are heartening, too few governments recognize the value of laying the groundwork for reform by communicating with citizens about the costs of existing programs and the benefits of alternatives. And there is no place for them to turn for a full-service solution that combines technical expertise with marketing capabilities. The GSEC would fill that gap by developing the following initiatives:

- *Public awareness campaigns targeted to specific markets in conjunction with local media, marketing experts, and government officials.* Such campaigns would communicate information about the negative consequences of fuel subsidies including: exacerbating income inequality, consuming a large portion of the national budget, contributing to corruption, and undermining the environment and public health. The campaign would also underscore how subsidies constrain a government's ability to make important investments in human capital and social safety nets. It would leverage research conducted by local governments, nongovernmental organizations (NGOs), the World Bank, and the IMF on who benefits and who loses from fuel subsidies. If credible research does not exist, it would commission it from an independent third party.
- *A communications campaign that informs citizens of the advantages of replacing subsidies with more effective alternatives such as cash transfers to the poor and a targeted social welfare mechanism that reaches societies' neediest with far greater efficiency and lower corruption.* Informing citizens of alternatives creates the conditions for a viable bargain: citizens will support subsidy reform if governments commit to replacing them with tangible alternative benefits. In Iran,

this was a cash transfer; in Ghana, the government raised the daily minimum wage and eliminated school fees. The campaign would disseminate information through radio, television, print, text messages, and social networks.

- *Technical solutions for implementing alternatives to subsides such as cash transfers.* The World Bank is already implementing mobile money and smart card payment systems, but the GSEC could help tailor such applications as specific end-to-end replacements for fuel subsidies.

The Global Subsidy Elimination Campaign would be beneficial for several reasons. Working in cooperation with local and international marketing agencies, it would leverage best practices from different country cases to devise innovative public-awareness campaigns. Being housed at the World Bank with its own board and budget (following a model similar to that of the Consultative Group to Assist the Poor), the GSEC would have access to the Bank's considerable research capabilities while being able to act nimbly and independently. For example, the partnership could take an active role on subsidy reform, in countries where the issue has not been a focus of the World Bank. The GSEC would also push the World Bank itself to prioritize subsidy reform. Over time, its marketing campaigns could be instigated by the World Bank in consultation with client governments or commissioned on a fee-for-service basis by wealthy countries.

The GSEC should be seeded with an initial budget of $100 million over three years: 10 percent allocated to finance internal operations and 90 percent to develop messaging and purchase media in three countries that agree to work with the GSEC as demonstration cases. Countries should be selected based on the relative magnitude of their subsidy problem and their willingness to implement a sound reform program. Yemen and Egypt are possible candidates. Yemen has begun to chip away at fuel subsidies that currently account for about 20 percent of government spending. Prospects for reform there will be enhanced by a well-communicated program that commits the government to reallocate savings to productive infrastructure investments and poverty alleviation programs; subsidy reform is also critical to relieving Egypt's fiscal crisis and freeing up funds for health and education spending. Nigeria, which abandoned a fuel price hike in January 2012 that it implemented with almost no prior communication and only vague promises of investing more in infrastructure, is another candidate. Subsidy reform will not succeed there unless the government is able to build trust that consumers will be compensated for higher energy prices. Spending $30 million in each of these markets on sophisticated, targeted media—including billboards, community radio, text messaging, and social media—would raise awareness that can be measured and evaluated through public opinion polls. Based on results, GSEC's work could expand to countries undergoing reform, which stand to benefit from a campaign that galvanizes support and decreases public hostility, and to those with an interest in undertaking reform, which would benefit from a campaign that lays the foundation for future policy.

The United States should jump-start the establishment of the GSEC by providing half its initial funding, with a challenge to raise the remaining half from others interested in the enormous potential of fuel subsidy reform. Such donors—including other countries, NGOs, the World Bank itself, and private foundations—should be motivated by an interest in poverty reduction and economic development, environmental concerns, and strategic considerations. Host countries should be required to contribute at least 10 percent of their specific marketing campaigns as buy-in to the process.

CONCLUSION

The success of efforts to curtail fuel subsidies is strategically important to the United States: geopolitically critical countries such as Yemen and Egypt will not see robust economic growth and political stability in the absence of successful fuel subsidy reform. The GSEC could play a pivotal role in communicating the harms of fuel subsidies and building support for shifting to more equitable and productive alternatives. Of course, public awareness campaigns will work only if matched by credible government action to replace subsidies with other, more effective investments, such as targeted cash transfers and productive health and education spending. But the potential upside of fossil fuel subsidy reform is so significant that it demands the funding of the GSEC concept.

Isobel Coleman is senior fellow for U.S. foreign policy and director of the Civil Society, Markets, and Democracy initiative. She is the author or coauthor of numerous books, including *Pathways to Freedom: Political and Economic Lessons From Democratic Transitions* and *Paradise Beneath Her Feet: How Women Are Transforming the Middle East*.