No. 251
November 16, 2022

KIEP Opinions

Energy Subsidies in the Middle East: Balancing Social Safety Nets and Climate Change

Munsu Kang
Ph.D., Associate Research Fellow, Africa and Middle East Team
Korea Institute for International Economic Policy

In the Middle East and North Africa (MENA), energy subsidies have been at the center of government budget reform since the 2000s. In the MENA region, energy subsidies are commonly provided as part of social contracts (Loewe, Zintl, and Houdret 2021). Over the years, the policy intention of governments in the MENA region, to reduce fuel and electricity prices and contribute to lowering living costs by providing subsidies, has led to debate over the economic, social, and environmental consequences of such measures (Fattouh and El-Katiri 2012).

In particular, fossil fuel subsidy reform can reduce emissions of greenhouse gases by 35% (Kuehl et al. 2021). However, while MENA countries have announced their net-zero schedules, phasing out fossil-fuel subsidies[1] still looks near impossible. This is because of the political pressure existing between social safety nets and environmental costs, namely in

[1] According to the International Institute for Sustainable Development (IISD), fossil fuel subsidies include subsidies for coal, natural gas, electricity, and petroleum products (IISD 2022). Among fossil fuel subsidies, 86% account for subsidies for consumption.

terms of energy subsidy reduction. According to IEA statistics, Iranian, Saudi Arabian, Algerian, Egyptian, and UAE energy subsidies rank the highest globally, together with China, India, and Russia. When it comes to subsidy reform, what are the challenges facing the governments of MENA countries?

First, fossil fuel subsidies in the MENA region are one of the compensation measures implemented by authoritarian leaders in Arab countries instead of restricting the political participation of civilians (Auktor and Loewe 2021). Subsidies including food, energy, transportation, and housing in the region have expanded from 1960s to 1970s as a form of social contract. The consumer subsidy scheme was used to stabilize local consumer prices rather than provide direct cash transfers. Fuel and electricity subsidies, in particular, enable people to participate in economic activities more actively. This indicates that high commodity prices in the region could trigger social tension and protests. For this reason, countries such as Jordan and Morocco failed to implement their subsidy reform policies in response to political instability in 2011 (El-Katiri and Fattouh 2017). Even globally, government subsidies for fossil fuels have almost doubled from USD 375 billion to USD 700 billion since the COVID-19 pandemic (IISD 2022). This fact confirms that energy subsidies are used to stabilize prices and social conditions.

Second, the demand for social safety nets in the MENA region is increasing rather than decreasing energy subsidies, and there may be resistance to any reduction in subsidies by the government without any alternative measures. Energy subsidy reform in Egypt and Iran, along with Morocco, is regarded as more advanced and with less domestic resistance (Auktor and Loewe, 2021). However, at the same time, debates on other forms of social safety nets such as supporting healthcare and education are increasing. For example, Moayed, Guggenheim, and von Chamier (2021) and Groot and Oostveen (2019) explain that subsidy reforms and cash transfer to the poor should be implemented together to effectively improve consumer welfare. However, as previous studies also emphasize the importance of public relations, only Iran, Morocco, and Egypt show progress in their reform processes. One reason that mechanism changes from subsidies to cash transfer are not prevalent might be because most net energy-exporting countries in the MENA are rentier states where there is pressure to change policy. In particular, rentier institutions such as the GCC grant welfare and public services to their people while the responsibility of managing oil and gas fields is given to the state. For this reason, rulers in rentier states must deal with the political pressure of changing their regimes, which might result in their losing management power over the hydrocarbon production.

As a response to climate change, GCC countries such as Saudi Arabia and the UAE have announced their net-zero plans. Several countries within the region have also announced green transition strategies. Hydrocarbons, however, are essential for economic growth in the region and increasing subsidies on renewable energy producers might be less efficient than supporting suppliers of hydrocarbon products at this time.

As governments in Morocco, Iran, Egypt, and Jordan have begun to reform their subsidies as a result of fiscal pressures since the 2010s, environmental perspectives are becoming more important for achieving nationally determined contributions (NDCs) and SDGs.[2] One of the aims of the UN SDG 12 is to "*rationalize inefficient fossil-fuel subsidies that encourage wasteful consumption by removing market distortions…*" (Baršauskaitė 2022). In order for MENA countries to move away from hydrocarbon economies to incentivizing the adoption of renewable energy technologies, it is necessary to shift subsidies from fossil fuels to renewable energy sources. In addition, alternative social safety nets need to be provided for civilians.

2 Note that Morocco, Egypt, and Jordan are net oil-importing countries (Al-Saidi 2020).

References

Al-Saidi, M. 2020. “Instruments of energy subsidy reforms in Arab countries—The case of the Gulf Cooperation Council (GCC) countries.” *Energy Reports*, 6(1), pp.68-73.

Auktor, G. and Markus Loewe. 2021. “Subsidy reforms in the Middle East and North Africa: Strategic options and their consequences for the social contract.” Discussion Paper, no. 12/2021. German Development Institute. https://doi.org/10.23661/dp12.2021

——. 2022. “Subsidy Reform and the Transformation of Social Contracts: The Cases of Egypt, Iran and Morocco.” *Social Sciences*, 11(2).

Baršauskaitė, I. 2022. “Background Note on Fossil Fuel Subsidy Reform.” *IISD.org*, August 29.

El-Katiri, L. and Bassam Fattouh. 2017. “A brief political economy of energy subsidies in the Middle East and North Africa.” *International Development Policy,* 7.

Fattouh, B. and Laura El-Katiri. 2012. “Energy Subsidies in the Arab World.” UNDP Arab Human Development Report Research Paper Series, United Nations Development Programme.

Groot, L. and Thijs Oostveen. 2019. “Welfare effects of energy subsidy reform in developing countries.” *Review of Development Economics*, 23(4), pp.1926-1944.

Kuehl, J., Andrea M. Bassi, Philip Gass, and Georg Pallaske. 2021. “Cutting emissions through fossil fuel subsidy reform and taxation.” GSI Report, International Institute for Sustainable Development.

Loewe, M., Tina Zintl, and Annabelle Houdret. 2021. “The social contract as a tool of analysis: Introduction to the special issue on ‘Framing the evolution of new social contracts in Middle Eastern and North African countries.’” *World Development*, 145.

Moayed, T., Scott Guggenheim, and Paul von Chamier. 2021. “From Regressive Subsidies to Progressive Redistribution: The Role of Redistribution and Recognition in Energy Subsidy Reform.” Research Paper. Center on International Cooperation, New York University.