

A photograph of an oil refinery at sunset. The sky is a mix of orange, yellow, and blue, with the sun low on the horizon. In the foreground, there are several large white cylindrical storage tanks with blue and white wave patterns at their base. In the background, there are various industrial structures, including distillation columns and a city skyline. A large white circular graphic element is on the right side of the image.

Energy Pricing Reforms in the Gulf: A trend but not (yet) a norm

GSI REPORT



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Introduction

Energy pricing reforms are a regional trend now that nearly all Middle East and North African countries—both oil importers and exporters—have undergone some level of recent reform. The last 10 years of international oil price volatility has made reform a necessity in most countries. Before the oil price collapse of 2014, MENA importing countries were paying a high price for subsidizing domestic energy consumption. They had to cover the price gap between low domestic prices and high international oil prices of more than USD 100 per barrel for several years. At the same time, exporting countries were making unprecedented profits from selling fuel on the international market, even though many started feeling the adverse impacts of low domestic energy prices.¹

This all changed when the oil price collapsed in 2014. Importing countries got some breathing space, as the price gap between domestic prices and international oil prices decreased considerably. Exporting countries, however, were severely hit. On average, countries from the Gulf Cooperation Council (GCC)² saw their total revenues decline by 10 per cent of GDP in one single year (International Monetary Fund [IMF], 2016b). For fiscal consolidation reasons, many of them had simply no choice but to also increase domestic energy prices. Even though they had known record revenues in the years before, their political and economic development systems had continued to rely on rent distribution through the cheap availability of domestic fuel, electricity and water. That system had been heralded as unsustainable for many years, but only after the price drop in 2014 did reality catch up for many of MENA’s exporters. Before that, reforms were not politically justifiable as there was no realistic sense of urgency.

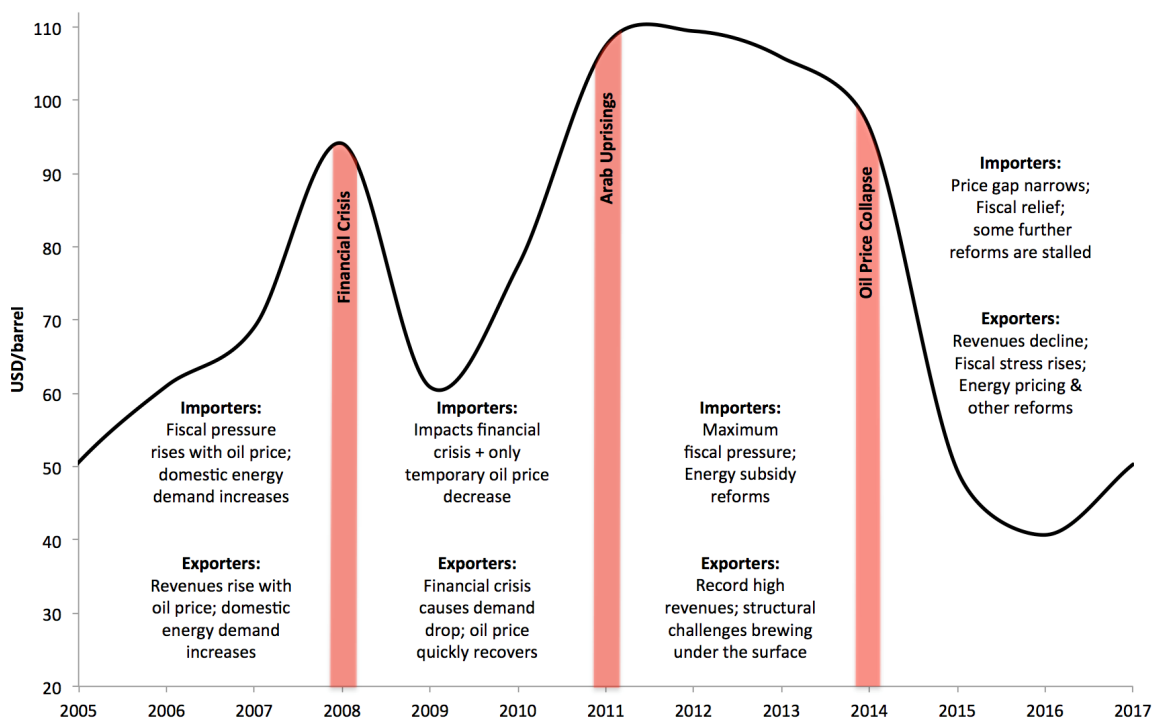


Figure 1. Oil price changes and events in the Gulf since 2005

Source: Author

¹ See the 2014 IISD report on Gulf Cooperation Council (GCC) energy subsidies: “The context of fossil fuel subsidies in the GCC region and their impact on renewable energy development” (Charles, Moerenhout & Bridle, 2014).

² Bahrain, Kuwait, Oman, Saudi Arabia, United Arab Emirates and Qatar



The development of an energy pricing reform trend in the MENA region cannot be understood without a broader reference to the political economy of welfare distribution. Whereas there are important differences between MENA countries, most had a political system based on the state-led distribution of welfare via in-kind benefits (such as energy, water and food subsidies) and public employment. This system of welfare distribution was (and is) ingrained in a social contract that gave the political elite fairly unrestricted political power in exchange. Governments were able to pay for this system by exploiting and trading natural resources.

Logically, lower-populated and resource-rich countries of the GCC are able to maintain such an allocation state model longer than importing countries in the MENA region, such as Egypt, Morocco or Jordan. Because of an increase in domestic demand and rising international oil prices, MENA importers became fiscally constrained and could no longer guarantee the distribution of welfare. This, together with rising socioeconomic inequalities, low economic opportunity and a lack of participation in politics, culminated in the Arab uprisings. Soon after, many MENA countries implemented energy price reforms to increase fiscal revenue. This was one of multiple, painful steps to begin the transition from an allocation state to a productive economy with better-targeted welfare and social security systems.

Similar challenges were brewing in many GCC countries. Deficient labour markets, rising poverty levels and a rapid increase in domestic consumption levels were offset only by governments able to spend a lot of money as a result of unprecedented high resource revenues. When the oil price dropped in 2014, GCC countries started experiencing higher levels of fiscal stress (Bahrain, Oman and Saudi Arabia) and had little choice but to reform energy prices. The extent of the shock was visible when other countries with smaller populations and comparatively large resource bases (Qatar and Kuwait) were also running deficits by 2016.

The pace of energy pricing reforms has varied among GCC countries and is often dependent on respective ambitions (and needs) to move from an allocation state to a more productive economy. This brief will highlight the similarities and differences between the various GCC countries. The goal of this paper is to put energy pricing reforms in the broader context of developmental challenges in GCC countries specifically, and the MENA region generally. Based on this context, it will draw lessons from recent MENA pricing reforms and give targeted advice for those institutions seeking to provide assistance to energy pricing reforms in MENA exporting countries.



2.0 GCC Energy Pricing Reformers: Similarities and Differences

2.1 Different Need to Reform: Fiscal Constraints

GCC countries are vastly different in the pace of challenges and reforms they face. They also have different political economies that determine how to deal with these challenges. With regards to fiscal pressure—most often the decisive reason for energy pricing reform—Oman, Bahrain and Saudi Arabia experienced more stress, and quicker, than the United Arab Emirates (UAE), Qatar and Kuwait (even though Dubai was the first to reform, due to the absence of fuel resources). The fact that international oil prices have only increased very slowly since the drop in 2014 (from USD 54 in January 2015 to below USD 30 in January 2016 up to USD 54 in September 2017) has made pricing reforms all the more necessary.

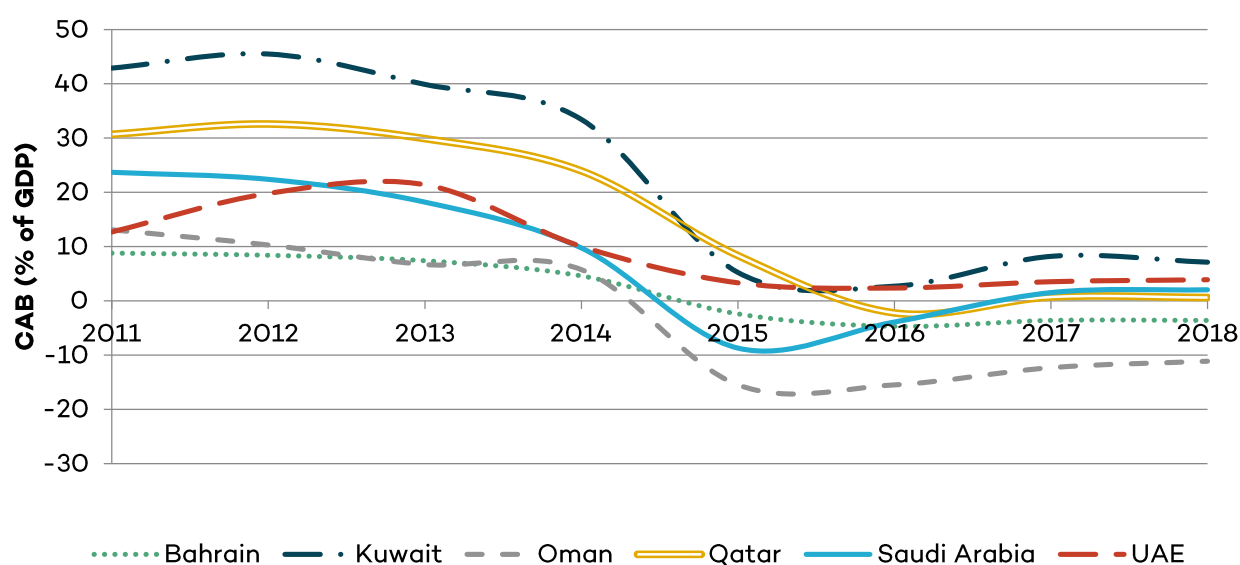


Figure 2. Current account balance (percentage of GDP)

Note: 2017 and 2018 are projections

Source: IMF, 2016c (up until 2013); IMF, 2017a (as of 2014)

Oman and Bahrain already had difficulties keeping a positive current account balance during high oil price years. Even if the Omani government cuts 8 per cent of spending as planned during 2017, it would still leave a deficit of at least 10.6 per cent of GDP (World Bank, 2017a). Bahrain, from its side, saw its deficit grow from 3.4 per cent in 2014 to 12.8 per cent of GDP in 2015 (World Bank, 2017a) and 18 per cent in 2016 (IMF, 2017d). The deficit is expected to fall to about 12 per cent in 2017, but with an expected increase in debt (IMF, 2017d). Saudi Arabia's current account balance turned negative in 2014 and the kingdom ran a very large deficit of USD 98 billion in 2015. Domestic reforms cut the deficit by almost USD 20 billion in 2016. The fiscal deficit is expected to decline from 17 per cent of GDP in 2016 to about 9 per cent of GDP in 2017 (IMF, 2017b).

Due to their relative overall financial strength, Kuwait, Qatar and the UAE seemed more resilient against the oil price collapse (Fattouh et al., 2016). In particular, Kuwait and Qatar have small populations and abundant resource reserves. Nevertheless, budget surpluses shrunk immediately. Kuwait recorded no surplus in 2016, and, according to the government's own definition, it actually ran a deficit of 17.5 per cent of GDP (IMF, 2017e). Kuwait has large financial buffers and low debt, but due to growing deficits its government is investing in seeking new means to finance the budget. In general, however, Kuwait is lagging behind on its neighbors in implementing structural reforms. Contrary to Kuwait, Qatar has implemented a significant adjustment to



government expenditure, including through energy price hikes. This seemed necessary as Qatar ran with a budget deficit of 9 per cent of GDP in 2015/16 (IMF, 2017g). The UAE is different from other GCC countries in that it has a more diversified economy and a better-established track record in charging higher domestic prices for oil than its regional neighbors. UAE's budget deficit increased only slightly from 3.4 per cent of GDP in 2015 to 4.3 per cent of GDP in 2016, again mostly as a result of low oil prices, but overall the UAE economy remains resilient (IMF, 2017c).

It is possible to conclude that reforms under lower international oil prices for Oman, Bahrain and Saudi Arabia have been undertaken quickly out of sheer necessity to improve fiscal spending. In addition to pricing reforms, some economies' long-term development plans (Bahrain Vision 2030, Oman Vision 2020 and Saudi Arabia Vision 2030) also give much more importance to the private sector than the long-term development plans of Kuwait, Qatar and the UAE (Hvidt, 2013a). The key goal of private sector development is to reduce the large public wage bill. Yet, recent experiences with global oil prices have moved Kuwait, Qatar and the UAE to also seek more private sector growth and adjustments in public expenditure (Moerenhout, 2017c). As will be discussed below, energy pricing reforms will be an important yet challenging step to enable private investment.

2.2 Different Pace of Reform: Developmental Challenges

The pace of energy pricing reforms is dependent on the combination of multiple developmental challenges in GCC countries. In the absence of other reforms, in particular social safety net reforms, merely reforming energy prices is likely to lead to political instability (Fattouh et al., 2016). It is crucial that energy pricing reforms are considered together with an improvement of social safety nets as part of a comprehensive reform process to gradually move from an allocation state to a productive economy. This process takes time and reforming prices over night is ill advised because energy pricing reform is not only part of the solution, it can also be a threat to socio-political stability.

It is more politically realistic to understand the pace of pricing reforms as dependent on the outcome of other comprehensive reforms. As mentioned earlier, central to the allocation state is the state-led distribution of welfare through in-kind benefits and public employment. Consequentially, citizens also have certain expectations toward the state in keeping its side of the social contract. To different extents in different GCC countries, this implicit political bargain faces two major challenges: rising poverty and deficient labour markets. Discussing long-term energy pricing reform without giving consideration to these two challenges is discussing the reform process out of context.

2.2.1 Poverty Linkages

The impacts of energy pricing reforms and the introduction of other fiscal consolidation measures are uneven across the GCC. Whereas universal subsidies have long been proven to be inequitable, they remain an important part of support for the poor because of their low purchasing capacity (Arze del Granado, Coady, & Gillingham, 2010; Coady, Flamini, & Sears, 2015). Per capita income is higher in Qatar, the UAE and Kuwait (even if there is a significant drop in Kuwait) than in Saudi Arabia, Bahrain and Oman, (whose populations are more likely to be vulnerable to fuel price adjustments). Saudi Arabia is particularly vulnerable to price increases and inflationary effects because it has a larger population size and more unequal per capita income (El-Katiri, 2016; IMF, 2016a). In simple terms: Saudi Arabia has a sizeable part of the population that is at risk of falling into the poverty trap. Any supporter of pricing reforms will therefore also need to give priority consideration to developing more targeted safety nets.

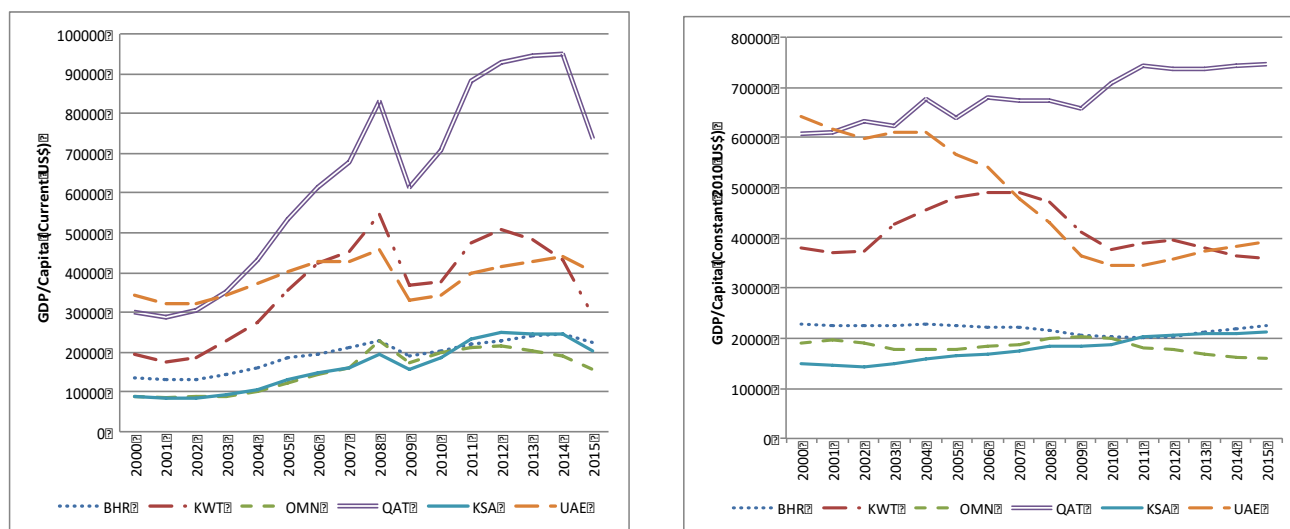


Figure 3. GDP per capita (current USD) Figure 4. GDP per capita (constant 2010 USD)

Source: World Bank, 2017b

GDP per capita statistics markedly show that a period of high external revenues has not necessarily trickled down to a large part of the population in Oman, Bahrain and Saudi Arabia (i.e., fuel subsidies were inefficient at reducing poverty structurally). When observing current prices, it may seem there was an increase in GDP per capita linked to the international oil price. However, an analysis of GDP per capita in constant prices (adjusted for the effects of price inflation) proves that to be wrong. Official poverty statistics are either non-existent or not publicly available. One estimate approximated that one-quarter of Saudi nationals could be in poverty, with many of the poorest in households of women who are divorced, widowed or those with a husband that is unable to work (Sullivan, 2013). Social safety net development needs to take this poverty problem into account. It seems Saudi Arabia has implicitly acknowledged this reality since it has repeatedly stated that no further reforms after the first pricing reform will be implemented before the Citizen's Account cash transfer program is up and running (Mahdi, Carey & Nereim, 2016). Whereas inflation rates before fiscal adjustments were relatively moderate across the GCC, subsidy reforms and other fiscal consolidation measures can lead to immediate spikes. Noteworthy is the doubling of the inflation rate in Saudi Arabia the month following its first fuel price reforms (Carey, 2016) and the prediction of volatile inflation rates over the next few years (IMF, 2016a).

The risk of increasing poverty in Saudi Arabia and other GCC countries is closely linked to population growth (including expatriates) and inadequate income. Since 2008, population growth has slowed down significantly in many GCC countries, particularly in the UAE (from 14 per cent to 1 per cent) and Bahrain (from 8 per cent to 1 per cent). While annual population growth rates are also slowing down for other GCC countries, they remain high compared to global standards (around 1 per cent). The annual growth rate in Saudi Arabia is over 2 per cent, in Qatar and Kuwait around 3 and 4 per cent respectively and in Oman significantly higher at around 6 per cent (World Bank, 2017b). This population growth is matched by roughly equal urban population growth rates.

The risk for an increase in GCC poverty is real. Continued current account deficits, potential capital flight with a consequential devaluation of, among others, the Saudi Riyal and other announced fiscal consolidation reforms (such as energy pricing reforms and the introduction of the value-added tax [VAT]) may all lead to inflationary pressure and a decrease in real income. Furthermore, the slowdown in public employment means that the traditional state-led safety net (i.e., price subsidies and public employment) is no longer fully available. Saudi Arabia and other GCC members should jump ahead of this stressful combination by designing a social



safety net that protects real income for poorer households without delay (see below). Looking ahead, such a safety net should also function to address the increasing wealth gap.

2.2.2 Deficient Labour Markets

Labour markets in the GCC are notoriously deficient and, together with regressive energy subsidies, one of the key reasons for an inequitable distribution of welfare. Historically, the public sector has been the main employer of GCC nationals, while expatriates cover most of the jobs in the private sector. About half of Bahraini and Omani working nationals work in the governmental sector. This goes up to 70 per cent in Saudi Arabia and 90 per cent in Qatar and Kuwait. In contrast, non-citizens make up more than 80 per cent of total private sector employment in all GCC countries. In Kuwait and Qatar, nearly all private sector jobs are covered by foreigners (GCC-STAT, 2017).

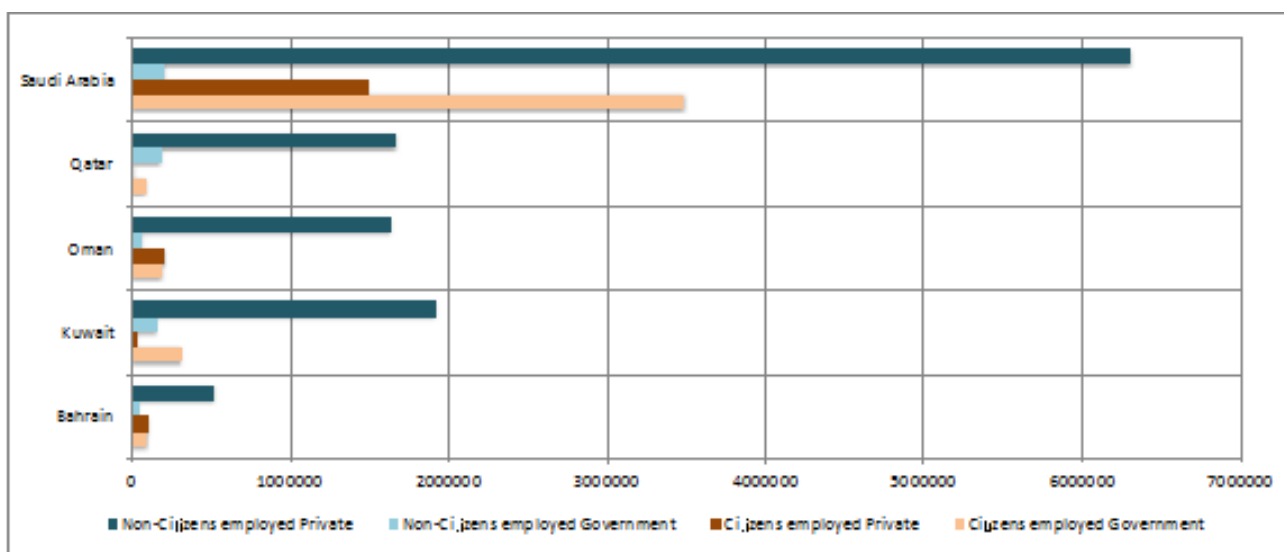


Figure 4. Absolute employment numbers in public and private sectors in GCC countries

Source: GCC-STAT, 2017

Despite large public employment rates, public and private labour markets are not inclusive. Particularly, increasing youth unemployment and a poor female labour participation rate remain structural problems. In Bahrain, Kuwait and Qatar, only about one out of three women is employed. In Oman and Saudi Arabia this is around one out of six and one out of eight respectively. Youth unemployment is also very high, with many young nationals having to wait multiple years before landing a government job. The level of youth unemployment is so high it could potentially be considered as a threat to national security.

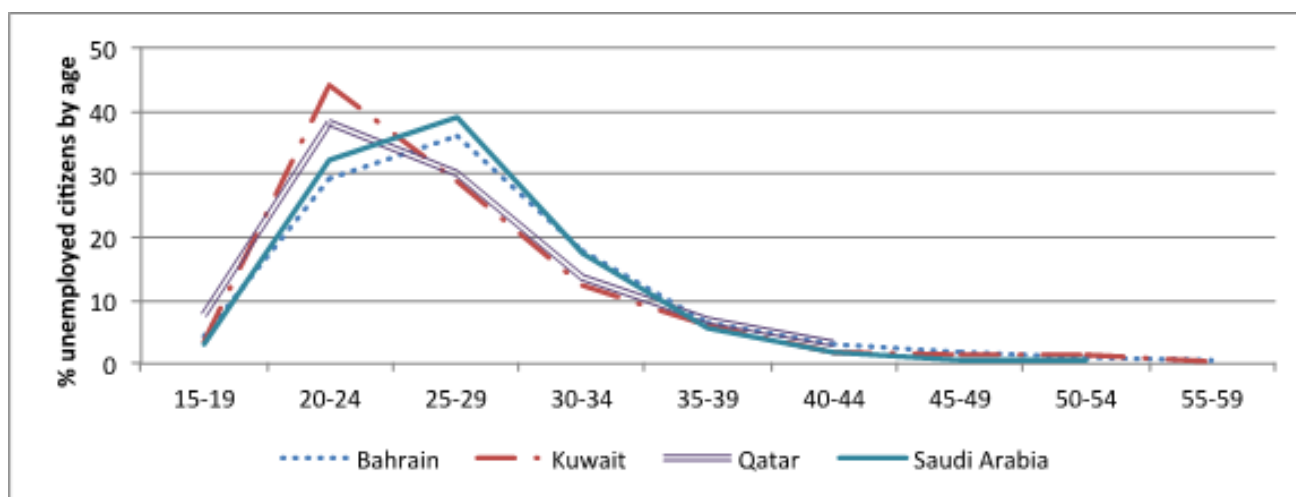


Figure 5. Percentage unemployed citizens by age group

Source: GCC-STAT, 2017

The benefits of public sector employment are many and reinforce existing structures of domestic labour distribution (El-Katiri, 2016). Public sector jobs provide higher salaries, more perks, higher job security, lower working hours and demand less performance than private employers. Hertog (2016b) argues that public sectors in GCC countries have shaped the expectations regarding salaries and working conditions for their nationals. Consequently, nationals are vastly underrepresented in the private sector. From one side, there is an expectation problem. Many do not want to perform low-skilled jobs given the ideal image of the public sector job. Most private GDP growth has been in lower-skilled sectors (IMF, 2014). From another side, there is a skill gap problem. Many nationals do not have the full skill set to perform high-skilled private sector jobs, even accounting for increasing education levels. More GCC nationals are getting tertiary degrees, but often in the humanities and with the expectation this will help to lock in a public sector job (Hertog, 2016a). As a result, most unemployed nationals have university degrees (as high as 56 per cent of unemployed in Saudi Arabia) (GCC-STAT, 2017).

The denationalization of the private sector is also rooted in the preference of private employers. Given the openness of GCC countries to low-wage migrants, the private sector can reduce costs by employing expatriates. The reliance on abundant and mobile cheap labour gives the possibility to adjust production by relying on labour adjustments, rather than by investing into more advanced production methods, which would then require higher skilled employees who could be sourced from GCC nationals. The reliance on such factor-intensive growth prevents a relationship of interdependence between GCC nationals and the private sector (Hertog, 2014, 2016a, 2016a; Hvidt, 2013b). At the same time, private employers that seek high-skilled jobs have noted that an insufficiently trained workforce is one of the biggest barriers to hiring locally (IMF, 2016c).

Since the drop in oil prices and associated revenues, countries have slowed down public sector employment to avoid an ever-increasing public wage bill. It is estimated that the public sector wage bill in the GCC grew from an average of 7.4 per cent in 2009 to 9.4 per cent of GDP in 2013. In Saudi Arabia, it reached 11 per cent (IMF, 2014). As a result, the government ordered a hiring and promotion freeze in government in 2015. It also cancelled bonus payments and cut ministers' salaries in 2016 (Carey & Nereim, 2016). Oman also initiated a public sector hiring freeze (IMF, 2016c), and Qatar ordered government state-owned institutions to reduce activities or lay-off expatriates (Cafiero, 2016). Kuwait also passed public wage reform, including an adjustment of high earning public sector employees. Due to a union strike, the oil sector (which generally has high wages) was largely excluded and was still able to pass a 7.5 per cent annual pay increase (Stratfor, 2016).



This comes at a time when other fiscal consolidation measures tightened private sector employment and stressed consumer-focused sectors. This again shows the need for social safety nets to protect real income for poorer households. A key goal of many GCC countries now is to tackle the productivity problem and increase private sector employment. Many are already using training programs as part of labour activation policies (IMF, 2016c), and some are working on adjusting the education system (Yamada, 2015). In recent years, countries such as Kuwait, Oman and also Saudi Arabia have experienced modest success in increasing private employment among nationals. In Saudi Arabia, this is unfortunately easily offset by the absolute growth of nationals in the labour force. It is safe to conclude that current activation policies are vastly insufficient to spark entrepreneurship, which is ultimately about the motivation to take risks. A structural reform of social safety nets could also have the goal to trigger such entrepreneurship, especially when cash transfers are implemented alongside other policies that seek to activate small businesses.

2.3 The Success of Pricing Reform Is not Measured by Merely Implementing Higher Prices

The success of energy pricing reform in the long run depends on the ability of governments to make progress on addressing the challenges described above in a holistic manner. This is generally a painful, controversial and unpopular process, which explains why oil exporters could choose short-term easy solutions and re-implement subsidies once the oil price picks up again. Therefore, the goal of reformers should not only be to implement price increases, but more so to implement price increases alongside policies that create tangible economic opportunities and better targeted social protection and welfare systems. Without results in those fields, further pricing reforms are likely to destabilize political systems.

Table 1. Energy pricing reform as part of the problem and the solution

Challenge	Maintenance of allocation state	Pricing reforms: potential problems	Pricing reforms: potential solutions
Political stability	Highly linked to volatility in the oil price	In-kind benefits remain the dominant form of welfare distribution; their reform poses a socio-political threat	Over time, a shift to a productive and more equal economy is impossible without energy pricing reform and delinking the economy from volatility in the oil market.
Fiscal stress	Highly linked to volatility in the oil price	/	Energy pricing reform opens up much needed fiscal capacity to finance deficits and implement other reform measures.
Domestic energy demand	Encourages demand increase rather than efficiency	/	Energy pricing reform sends an incentive to consumers to consume less energy, and become more energy efficient.
Poverty	Disproportionate benefit for the rich; poor track record in resolving structural poverty problems	Besides having to pay higher energy prices, energy pricing reform can also cause inflationary shocks	Low energy prices disproportionately benefit the rich. Reforming prices in combination with more targeted social safety can ultimately create a net benefit for the poor.
Deficient labour markets	Focus on one resource and state sector public jobs	Energy price increases and associated inflation can in the short term negatively affect business and employment.	Because businesses are not incentivized to invest capital into energy efficiency, they use foreign labour to adjust their productive decisions. Energy pricing reform will eventually require investments and result in higher paying jobs for nationals.
Gender	Gender implications from limited access to subsidies aimed at transport fuels or state jobs reserved for men	/	Transition to a productive economy encourages female participation in the economy.

Source: Author



The political economies of GCC countries are often entangled with their ability to sustain an allocation state model. From one side, states like Kuwait and Qatar are, in theory, in a unique position to make gradual adjustments over time to move to a productive economy. But maintaining the allocation state is more popular and it requires lower administrative capacity. In addition, the nature of the democratic process in Kuwait means that the parliament checks the government and generally opposes any unpopular fiscal consolidation measure (see below). The parliament is elected, while the government is appointed by the emir, a situation often leading to political opposition between the two, with the parliament protecting public welfare and the government trying to reform according to fiscal needs. From another side, states like Oman, Saudi Arabia and Bahrain need to reform more quickly, and their political economies are gradually adjusting to this new reality. For example in Saudi Arabia, a new generation of political players under the leadership of Crown Prince Mohammad Bin Salman appears reform minded and seeks comprehensive reforms over time. The UAE is in a special position as it has a more diversified economy and has traditionally charged relatively higher prices to its domestic consumers. This has been a conscious, rational decision to maintain oil as a strategic asset for the long run (Moerenhout, 2015).



3.0 Recent MENA Energy Pricing Reforms

3.1 Pricing Reforms in MENA Fuel-Importing Countries

In the immediate aftermath of the Arab Spring, many Arab governments resorted to conventional measures such as an increase in subsidies and public employment benefits to appease the (sizeable) popular opposition. Soon after, however, most North African countries started developing structural reform plans to transition to a new and more healthy economic and fiscal paradigm. At the centre of these plans was the acknowledgement that energy subsidies needed to be reformed. Not only are they regressive (disproportionally benefiting the rich), but they also lead to excessive domestic demand. Most of all, in a time of over USD 100 barrel oil prices, these subsidies became fiscally unsustainable.

Morocco has been the leader in energy subsidy reforms and is critically acclaimed to have succeeded in implementing gradual reform early. By 2012, fuel subsidies accounted for 6.6 per cent of its GDP and 17 per cent of its budget (Kojima, 2016). In response, Morocco raised gasoline, diesel and industrial fuel prices by respectively 20 per cent, 14 per cent and 27 per cent in 2012. This sizeable increase was further deepened in 2013 and the subsidy for all three was eliminated in 2014 and 2015. Then kerosene subsidies were eliminated by November 2015. Electricity prices were slowly raised. Due to its position as a poor household fuel, LPG prices have not been reformed to date (Moerenhout, Vezanis, & Westling, 2017). Because of these reforms, Morocco reduced the deficit by 2 per cent of GDP (El Massnaoui & Verme, 2015).

In **Tunisia**, energy subsidies reached 3 per cent of GDP before the government decided on reform. Even though the country had known relative economic stability since independence, high political insecurity and an increasing level of government debt led to a downgrading of its credit status, which, consequently, affected its competitiveness (Moerenhout et al., 2017). As oil prices rose, Tunisia raised the prices of gasoline, diesel and electricity by roughly 7 per cent per year from 2012 to 2014 (Moerenhout et al., 2017). Early in 2014, the government also started reforming prices for the cement industry and linked the evolution of domestic fuel prices to that of international prices. Since the drop in oil prices in 2014, the government postponed a number of energy pricing reforms (Kojima, 2016). In 2016, Tunisia implemented a new pricing mechanism for gasoline and diesel and adjusted gasoline and kerosene prices upward by increasing excises. Diesel prices, on the other hand, were lowered (IMF, 2017a). Whereas there was less fiscal urgency to continue reforms after the 2014 price drop, Tunisia still has a long path ahead to move away from its subsidy-based welfare system. As the oil price picks up, new subsidy reforms will inevitably be necessary.

In **Jordan**, exogenous shocks (level of oil price and supply disruptions from Egypt) increased the price of imports and fiscal stress. In the aftermath of the Arab Spring, Jordan's growth had decreased by almost 4 per cent (to 2.6 per cent) and the current account deficit had increased by 5 per cent (to 12 per cent) and was continuing to grow. In response, Jordan requested assistance from the IMF and was required to implement fuel price reforms. It eliminated subsidies to gasoline, diesel and other fuels in 2012. Between 2012 and 2014, gasoline prices increased by roughly 14 per cent, diesel and kerosene prices by 33 per cent and LPG by 54 per cent (Kojima, 2016). Since fuels were liberalized, prices dropped in 2014/15. A price-setting committee that meets monthly has continued to increase fuel prices in line with international prices as they picked up again, recently with a 3 to 8 per cent increase of gasoline, diesel and kerosene prices (The Jordan Times, 2017). The key challenge for Jordan now is to reduce the burden of electricity prices. Whereas electricity tariffs have increased moderately, electricity subsidies—themselves driven by subsidized fossil fuel inputs to power generators—still pose a significant burden on Jordan's fiscal stability (Moerenhout et al., 2017). Some planned price increases remained unimplemented during 2016 (IMF, 2017a). Currently, a majority of Jordanians receive low prices via the block tariff system. In addition, bill collection remains a problem across the country.



Since President Sisi was elected in **Egypt**, large-scale subsidy reforms took place in July 2014 and August 2016. After the Arab Spring, energy subsidies amounted to 8.5 per cent of Egypt’s GDP. Between 2010 and 2013 the deficit had increased from 8 per cent to 14 per cent of GDP and debt had increased from 73 per cent to 89 per cent of GDP. Before Sisi, President Morsi had initiated a number of moderate energy subsidy reforms that shielded households. As the fiscal and economic crisis grew worse, Sisi immediately increased prices after being elected in June 2014. In the years following, he lost popularity and therefore paused reforms. Partly due to the drop in international oil prices, the GCC stopped supporting Egypt with direct cash and fuel. As a result of the enduring fiscal crisis, Sisi had to reform energy subsidies further in August 2016 as a condition to unlock a much-needed IMF loan (Moerenhout, 2017a).

Table 2. Key energy subsidy reforms in Egypt

	Key 2014 Energy Price Increases	Key 2016 Energy Price Increases
Gasoline	78% (gasoline 80), 41% (gasoline 92), 7% (gasoline 95)	47% (gasoline 80), 35% (gasoline 92), price allowed to float (gasoline 95)
Diesel	64%	/
Kerosene	64%	31%
Natural gas	33-204% (energy intensive industries), >200%, 500%, 700% (low – medium –high users)	+/- 50% (low to medium users), 33% (heavy users)
Heavy fuel oil	50% (cement), 30% (bricks, other users), 40% (bakeries and food)	7% (most users)
Electricity	< 50% (low users), +/- 17% (commercial and other residential)	Up to 40% residential, up to 20% commercial (mainly medium & heavy users)
Liquefied petroleum gasoline	/	87%

Source: Moerenhout, 2017a

3.2 Pricing reforms in GCC exporting countries

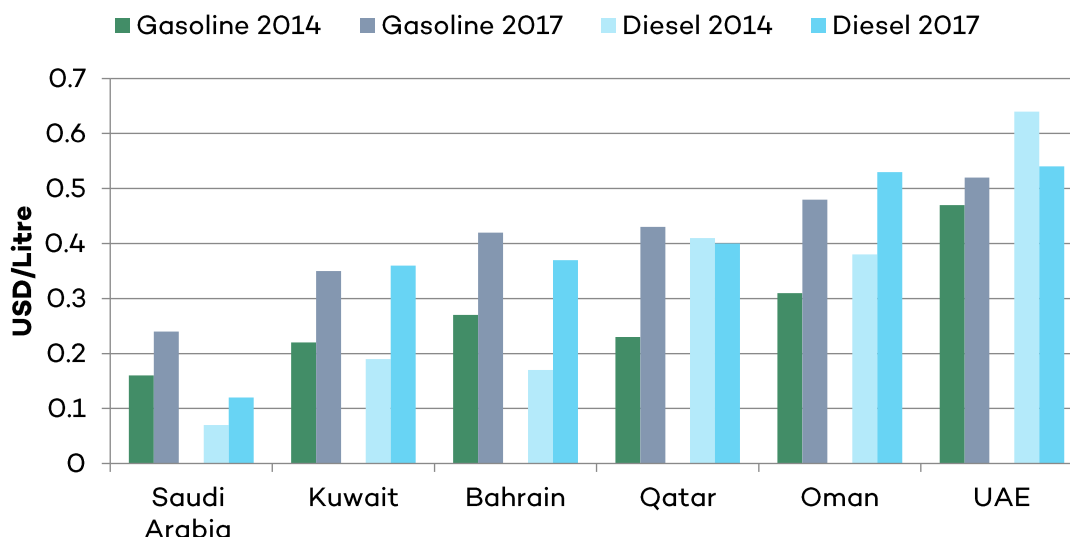


Figure 6. GCC transport fuel prices before and after reforms

Source: GIZ, 2014 (2014 data); Globalpetrolprices.com, 2017 (2017 data)



Historically, **Saudi Arabia** has had among the lowest energy prices in the world. Consequentially, its decision to rationalize energy prices implied a long structural adjustment process. In December 2015, the government significantly increased prices for nearly all fossil fuels. The increases affected key energy-intensive industries (Moerenhout et al., 2017), which were concerned over their competitiveness (Arab Petroleum Investments Corporation [APICORP], 2016), and continue to be so in the eye of future reforms. Households were primarily affected by the increase of transport fuel prices (50 per cent for 95 octane to USD 0.24 per litre, 67 per cent for 91 octane to USD 0.2 per litre, 80 per cent for diesel to USD 0.12 per litre for transport and USD 0.09 per litre for industry). Secondly, households were also affected by higher electricity prices in 2016. Households with a consumption of 4,000–6,000 kWh per month saw prices increase by two thirds to a level of USD 0.05 per kWh, while electricity prices for households with even higher consumption were unified at a level of USD 0.08 per kWh. Those who consumed less than 4,000 kWh per month were excluded from reforms (Fattouh et al., 2016; IMF, 2017a). Even with higher retail prices, tariffs do not yet cover the cost of production, particularly since the prices of fuels used for power generation were also increased. Methane and ethane prices were also raised in 2015 by 66 per cent and 133 per cent respectively to USD 1.25 per litre and USD 1.75 per litre (IMF, 2017a). Saudi Arabia also increased its water prices, which received the highest public backlash, leading to the water minister's resignation. Even though reforms are unpopular and inflation spiked right after reform, Saudi Arabia announced its goal to gradually increase energy and water prices over a 5-year period (IMF, 2016a).

The **UAE** habitually charges higher energy prices than its GCC neighbours. As price increases were not that uncommon before the fall in international oil prices, recent energy pricing reform efforts have been less of a shock than in other countries. Moreover, the government strived to protect UAE nationals. In 2015, the Emirates also increased electricity and water tariffs for expats, commercial, industrial and government sectors, but shielded nationals from reforms (King Abdullah Petroleum Studies and Research Center [KAPSARC], 2016). In August 2015, the UAE liberalized transport fuel prices and linked its new pricing formula to international market prices. While this might appear to be a bold move, the real impact was low. Because of low international prices, gasoline prices increased by only 25 per cent in 2015, whereas diesel prices actually decreased by roughly 29 per cent (IMF, 2015). That said, so far the government has stuck to reforms and increased prices monthly to follow the gradual increase of international oil prices (Gulf News, 2017).

Oman is experiencing high fiscal pressure and therefore has high pressure to reform energy prices. Like many other countries in the MENA region, it first started adjusting prices for industrial producers before moving to price increases that affected its citizens. In January 2015, it doubled natural gas prices for industry and power producers. It also announced its intention to increase electricity prices to bring it close to cost-recovery levels. Current plans start with charging cost-reflective electricity tariffs for industrial and other large consumers (James, 2016). Households were primarily impacted by an increase in transport fuel prices. Compared to Saudi Arabia, the percentage increases were modest, even though the absolute prices are by far larger. In January 2016, premium gasoline prices increased the most, from USD 0.31 to USD 0.42 per litre. Regular gasoline prices only increased by about 20 per cent to USD 0.36 per litre and diesel prices increased from USD 0.38 to 0.42 per litre. To ensure a gradual reform process, Oman also set a fuel pricing formula that takes account of international fuel prices and prices in the UAE (KAPSARC, 2016). As such, it has made monthly adjustments to both gasoline and diesel prices, lifting the gasoline price to USD 0.48 per litre and the diesel price to USD 0.53 per litre in February 2017 (IMF, 2017a).

In common with Saudi Arabia and Oman, **Bahrain** experiences higher fiscal pressure than the other GCC countries. In 2013, it already tried to raise household energy prices but failed because of Parliamentary opposition (APICORP, 2016). It did increase tariffs for electricity and water for non-domestic use. In March 2015, like Oman, it further increased industrial natural gas prices after a number of other changes in the past years (annual increase of USD 0.25 mmbtu). In January 2016, it effectively raised regular and premium gasoline prices by respectively 56 per cent and 60 per cent (IMF, 2017a). It also planned for an annual diesel price increase of USD 0.05 per litre. The Bahraini government also aims for a gradual increase of electricity and



water prices to cover an estimated electricity production cost of USD 0.77 per kWh. So far, this increase is only intended to reach expatriates and Bahrainis with multiple accounts (Fattouh et al., 2016). Bahrain foresees for annual price increases effective March 1, 2017 until 2019 (Bahrain Electricity and Water Authority, 2016). Its goal is to increase prices by 95 per cent during that period, again with nationals exempted on their first home (account) (IMF, 2017a).

Qatar increased all transport fuel prices early in 2016. Premium gasoline prices were increased by 35 per cent from QAR 0.85 per litre to QAR 1.15 per litre. Regular gasoline prices rose at similar levels from QAR 1 per litre to QAR 1.30 per litre. In 2014, it had already increased diesel prices by about 50 per cent (Walker & Kovessy, 2016). In May 2016, the government announced its intention to liberalize petrol and diesel prices and adjust future prices to factors taking account of international and regional prices, as well as cost of production. Since June 2016, the ministry has adjusted transport fuel prices monthly. From June 2016 until March 2017, petrol prices increased by about 30 per cent and diesel prices by about 10 per cent (Khatri, 2017; The Peninsula, 2017). In a similar vein, Qatar also announced the adjustment of electricity and water tariffs. These are yet to be implemented at the time of writing, with the last tariff hike implemented in 2015.

Driven by its strong financial position and abundant resource reserves, **Kuwait** has seen strong parliamentary opposition against energy price increases. The government increased diesel prices in January 2015, but had to partially reverse on those reforms the month after due to domestic protest (from 200 per cent to 100 per cent, with large consumers continuing to receive diesel at the original price). The government increased gasoline prices in September 2016 by about 70 per cent on average and planned to revise prices in line with international price movements. While this price reform was challenged in court, it remained implemented. However, there have been no further price adjustments since. There were also planned electricity price increases for May 2017. These price rises do not affect Kuwaiti residents (IMF, 2017a). Because of the large opposition from the Kuwaiti Parliament and labour unions to the petrol price increase, the government announced it would bring in compensation measures such as a certain level of free petrol per month (The New Arab, 2016). At the time of writing, this fuel quota is beginning to be implemented, slowly.

3.3 Is There Now a Regional Trend?

A regional trend seems to have unfolded as both importing and exporting countries have reformed energy prices in recent years. Caution remains, as the upward adjustment of energy prices is far from being a norm. Rather, it is a real and largely unpopular part of a necessary move from an allocation state model to a more productive economy. It is therefore easily conceivable that if oil prices structurally increase again, many fuel exporting states in the MENA region could stop and even reverse reforms.

Similar reactions were observed among MENA importers when the oil price dropped. After 2014, Egypt did not implement any pricing reforms for 2 years, and then only when it was a condition for accessing an IMF loan. In 2015 Tunisia also suspended its gasoline, diesel and electricity price adjustments. It only reinitiated the partial implementation of reforms in the summer of 2016. Nonetheless, the fact that many countries are openly debating energy pricing reform and setting forth a strategy of moving to a more productive economy is a promising development. International experts can support this trend not just by pushing norm-setting efforts, but more so by delivering more specialized technical assistance and capacity building in areas such as demand efficiency measures, diversification of the energy mix and in the development of more sophisticated social welfare systems. The spillover effects of successful pricing reforms and associated policies could outweigh the potential of norm-setting efforts to encourage long-term pricing reform processes.

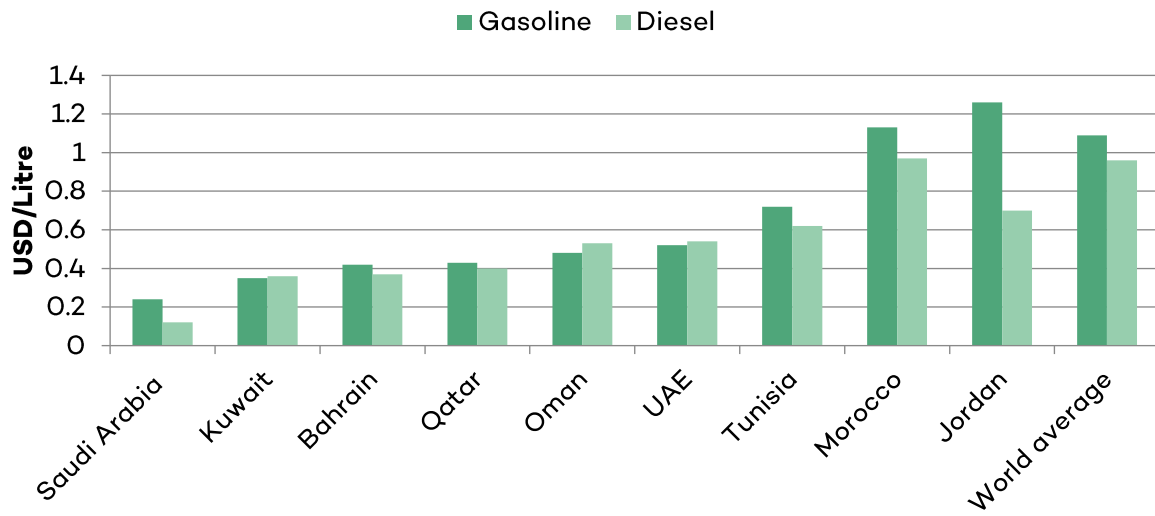


Figure 7. GCC transport fuel prices in comparison

Source: *Globalpetrolprices.com, 2017*



4.0 Providing Constructive Assistance to Support GCC and MENA Pricing Reforms

4.1 Pricing Reform Needs to be Addressed Holistically

Pricing reform is more than just a way to open up fiscal capacity for governments. It should be understood within the context of redefining the social contract between citizens and government, which also inevitably means a redefinition of the responsibility of each. Even if in countries like Bahrain, Oman and Saudi Arabia, the rentier logic of state-led distribution of oil-revenue-based welfare no longer fully copes with realities on the ground, the central role of the distributive state in the country's political culture remains virtually untouched. Such path dependency contrasts with the developmental plans of these countries that explicitly foresee a move away from the allocation state to a more productive economy. Reform will need to be gradual, and factor in citizens' expectations, rather than aiming at just raising prices quickly.

Table 3. The allocation state, the productive economy and the transition process

Allocation State	Transition Process	Productive Economy
In-kind benefits with infrequently changed ad hoc pricing	Pricing reforms (energy, food, other) & introduction of value-added & excise taxes	Market-based pricing that incentivizes responsible consumption
Universal and untargeted transfers	Ability to collect social data & design policies accordingly	Targeted welfare subsidies and social safety nets
Mostly public employment of nationals	Labour market and immigration policy reform to "nationalize" private sector employment	Mostly private sector employment and narrowing of public-private wage gap
No or low taxation on business	Levy of corporate taxes and enhanced policies aimed at private sector	Interdependency between private sector, citizens and government
No or low taxation on income	Introduction of progressive income taxation scheme	Progressive income taxes to finance government's social responsibility

Source: Author

To be successful, this immense transition process also involves changes in social structures and administrative capacity. With regards to the former, the existing citizen's dependency on the state undermines the autonomy of social development among the country's citizenry (Kamrava, 2011). While useful to prevent the formation of significant political opposition, a sense of social autonomy is key to developing economic entrepreneurship. Higher levels of social divergence are correlated to lower total factor productivity and per capita income (Grafton et al., 2004). GCC countries thus have to strengthen the ability to cluster socially and exchange ideas (Baldwin, 2016). This is currently essentially missing. Countries want a private sector that is young and linked to domestic ownership of small and medium-sized enterprises. In reality, consumption-oriented sectors are under pressure. At the same time, rural areas are invested in considerably less, even though they are still populous (Luciani, 2017). And finally, the role of women, particularly in Saudi Arabia, remains virtually untouched, which forecasts a continued underrepresentation of women in the domestic economy (El-Katiri, 2017). Changing these social structures cannot simply happen overnight. As energy pricing reform is part of a larger transition process, it needs to be patient for the holistic picture to develop.



The transition process also requires developing stronger administrative capacities. Currently, many bureaucracies remain immature and fragmented, with unclear lines of accountability and overlapping mandates across ministries and agencies. Hertog (2010) articulated the notion of “islands of efficiency” to explain why and when certain reforms succeed in rentier states. He argues that deep, cross-cutting reforms often fail, but that when the authority for reform falls within one institution, they can succeed. This is particularly so when the implementation of such reforms is outsourced to a dedicated autonomous part of the bureaucracy (“the island of efficiency”). The argument is convincing and at heart it shows that a lack of experience with horizontal coordination and the need for clear channels of authority and finance determine the success of reforms.

There is no quick move to a mature administrative apparatus as a support for reform. Rather, reform processes should prioritize consolidating responsibility in those parts of current administrations that work efficiently. This requires the leadership of the most powerful people in government. While planning ministries seem like a logical leader to develop novel methods of social security provision, the political reality is that such ministries often receive limited power (Hvidt, 2013). For example in Saudi Arabia, new institutional development and appointing top-level positions were part of the Deputy Crown Prince’s (now Crown Prince) consolidation of power (Hertog, 2016a). An ambitious reform plan should therefore always be closely linked to the centre of political authority, which, among other benefits, also gives access to the required level of finance.

4.2 Short-Term Needs to Facilitate Energy Pricing Reforms

4.2.1 Social Safety Net Development and Social Mitigation Measures

Central to the ability to implement energy pricing reforms is the rapid development of social safety nets, not least because energy pricing reform effects (higher prices and inflation) can have a disproportionate impact on essential spending by poorer strata of the population. For example, rising food prices can be a politically controversial consequence of energy pricing reforms (Lahn, 2016). Many countries in the region have differentiated tariffs according to national/non-national divides or according to income (for electricity tariffs), but few have succeeded in developing more structural safety nets. This is now on the rise. For example, Saudi Arabia has publicly promised there will be no more pricing reform until a cash transfer program (Citizens’ Account) is operational. In February 2017, Oman also fixed the price for regular gasoline until a mechanism is in place to mitigate the negative effects on poorer parts of the population (IMF, 2017a).

Implementing new types of social safety nets is no easy task. Indicative is the delay of the implementation of the Saudi Citizens’ Account cash transfer program. While originally intended to launch in June 2017, the program has yet to kick off. Difficulties related to its implementation ultimately means that energy pricing reforms have been delayed as well.

For high rentier countries like the GCC states, cash transfer programs are often heralded as the best first step in developing new social safety nets. They are popular among citizens and easier to administer than other (more advanced) methods of social safety. They are, however, a heterogeneous form of social protection. Cash transfers can vary in what beneficiaries they reach, how they are financed, what the level and duration of benefit is, how registration happens, how the transfers are delivered and how they are institutionally set up. Different GCC countries could opt for different types of cash transfers. Those with larger financial buffers could choose for a universal transfer, while others might need some type of targeting mechanism.

Technical advice to advance in this area would greatly benefit the pace of energy pricing reforms (Moerenhout, 2017b; Inchauste & Victor, 2017). While taking into account income inequalities, the coverage of new social safety nets should remain sufficiently broad, and the measures highly tangible in terms of real income. Such measures would be in line with the observed rentier reflex in response to the Arab Spring (Moerenhout, 2015) and would be able to garnish a political consensus. This is particularly necessary in states with strong, populist Parliaments (e.g., Kuwait and Bahrain) that have demonstrated in the past (among others vis-à-



vis energy pricing reforms) the willingness to undermine government to represent the citizens' short-term interests (APICORP, 2016). That said, broad cash transfers require caution as well, as was shown in the Iranian experience. Iran had a universal cash transfer whose initial popularity helped the implementation of pricing reforms. Due to international sanctions and other factors, however, the real value dropped due to inflation, and support for further reforms plummeted.

Complementary to cash transfers, it is possible to design and implement a number of other mitigation measures that can target specific stakeholders and ease opposition to pricing reforms. Implementing such mitigation measures is also helpful to gain experience for medium-term social safety development. The existing portfolio of possible measures is wide and includes food subsidies, transport subsidies, free fuel allowances, electricity block tariffs and employment activation measures (Moerenhout, 2017b). The choice of mitigation measures is country-specific and depends, among others, on institutional capacity and perceived popularity. Technical assistance providing in-depth analyses of possible compensation measures and their practical set up would speed up reform processes.³

4.2.2 Communication Campaigns

Many of the GCC pricing reforms that happened in the wake of the oil price drop were not accompanied by communication campaigns. Yet, the rise of social media means governments can no longer control the flow of information. This is a potential risk as there is a certain level of feeling of entitlement to free or low-cost energy. One 2016 survey in Saudi Arabia found that more than 85 per cent of young nationals believe energy should be subsidized (Nereim, 2016). It appears essential that, to be successful, further pricing reforms should be accompanied by targeted communication campaigns (Fattouh et al., 2016).

Communication campaigns in support of energy pricing reform are by now more of a norm than the exception. Morocco's energy pricing reforms were accompanied by an extensive campaign to educate its citizens on energy subsidies and their regressive nature (Fattouh et al., 2016). Similarly, Tunisia set up a communication strategy to stress that the rich benefited from energy subsidies more than the poor by more than 40 times. The government also spent significant resources in setting up communication campaigns toward internal policy-makers (Moerenhout et al., 2017). In stark contrast with the Mubarak years, the Egyptian government also set up a communication campaign in anticipation of Sisi's election and subsequent energy pricing reforms (Moerenhout et al., 2017).

Technical advice can benefit communication campaigns in many ways. It can provide input by conducting public opinion surveys, setting up focus group discussions and in-depth interviews with key stakeholders. A better understanding of who is or feels excluded from the current system, and how, can be used in a messaging campaign. This preparatory process in itself can already achieve a certain level of buy-in. Experts can also introduce insights from behavioural psychology, the use of which has been extremely successful in many business applications. It can bring such knowledge into draft messaging strategies and test these on various consumer groups. This type of communication work is not just useful to explain the problems of energy subsidies, but also to gather support for reform or improve revenue collection.⁴

4.2.3 Statistical Capacity and Modelling

Many MENA governments could benefit from enhanced quantitative analysis capacity both in terms of social data collection and with regards to scenario modelling. Improving social data collection requires enhanced administrative capacity to measure, collect and synthesize such data. Income data in many countries remains fairly unreliable (e.g., poverty statistics in Saudi Arabia) and this represents a problem for the identification of beneficiaries for compensation measures. In response, many MENA countries are now working on setting

³ For an example of such in-depth analysis of various compensation measures, see Global Subsidies Initiative (GSI), 2016.

⁴ For example, GSI has supported the development of communication campaigns with the World Bank and governments in Egypt, Iraq and Iraqi Kurdistan and with other stakeholders in India.



up unified national registries. This, however, requires large amounts of institutional and technical innovation (Moerenhout, 2017b). Besides social data collection, the capacity to model the direct and indirect impacts of various reform scenarios can contribute to setting up better reform plans and developing well-adjusted mitigation measures (both for households and businesses). Many GCC governments have dedicated researchers working on such modelling (e.g., KAPSARC in Saudi Arabia provides such a service).

4.2.4 Addressing Competitiveness Concerns

With decades of low energy prices, energy-intensive industries are among the more important businesses in GCC and other MENA countries. Reforming energy prices negatively affects industries in general and energy-intensive ones in particular (Lahn, 2016). Whereas medium-term development plans will inevitably create winners and losers, mitigating some of the adverse effects of energy pricing reform might be necessary to maintain a certain level of industrial competitiveness on the short term. Currently, there is little analysis on what competitiveness impacts energy pricing reform has on various industries, how such impacts could be best mitigated and under what conditions. Consequentially, energy pricing reforms in the GCC so far have not included mitigation measures for industry (APICROP, 2016).

4.2.5 Institutional Setup

All the above aspects of energy pricing reforms often require new types of institutional operations. It has been long understood that one problem in many MENA countries is the unclear and overlapping portfolios of various agencies. A complex bureaucratic web hampers efficient policy-making and implementation. The various aspects of energy pricing reform can be an opportunity to address some of these shortcomings. Including international experts and consultants can be beneficial in two ways. From one side, it can bring in ideas to restructure certain administrative modus operandi. From another side, it can be a method for governments to level up self-discipline and implement otherwise difficult and controversial internal governmental reforms.

4.2.6 Establishing Regional Learning Platforms

Together, MENA countries have invaluable experience in the various facets of energy pricing reform; from setting up communication campaigns to starting and developing cash transfer programs. Yet, there are very few platforms in which countries share their experiences and elaborate potential best practices. While there is useful third party analysis (for example IMF 2015 and IMF 2017a), a confidential platform where policy-makers interact directly would have the benefit of strengthening regional learning.

4.3 Assistance Needs to be Void of Normative Considerations

Despite implementing domestic reforms and supporting pricing reform in a regional context, GCC countries remain skeptical about the normative debate around fossil fuel subsidies. Mostly, they worry about an insufficient accounting for the importance of low energy prices to the political systems of many countries in the MENA region and beyond. External pushing for rapid energy pricing reform can appear as an intervention that is unaware of the tradition of welfare distribution and its impact on political stability (Moerenhout, 2017c). Technical advice around subsidy reform would therefore be more effective if it stays void of normative considerations.

The history of international engagement with GCC (and other oil-exporting) countries is tainted by this debate. For a long period, the key discussion was on whether low energy prices in oil exporting countries indeed constituted “fossil fuel subsidies.” In the eyes of many oil producers, the benchmark to calculate subsidies should be the actual cost of production (IEA, OPEC, OECD, World Bank, 2011). This means that a subsidy would only exist if domestic fuel prices fall below the production cost (which is based on the long-run marginal cost of supply). Within the domestic context of oil producers, this is intuitively correct (Luciani, 2014; Lahn,



2016). Most international institutions, on the other hand, calculate subsidies based on an opportunity cost approach. Under this approach, the benchmark is not the cost of production but rather the international market price at which fuel could be sold. Others, like the IMF, go even further and include externalities on top of an international price benchmark.

As such, low energy prices in oil-producing countries were perhaps too easily universally labelled as subsidies. It is conceivable that the “subsidy” labelling by certain parts of the international community was experienced as an effort to advance an international norm against fossil fuel subsidies. As there are different economic logics behind the definition of “subsidy,” an agreement between exporters and international institutions remains difficult to find. That said, a push from the latter happened without sufficient consideration for the domestic context of exporting countries. At that time, exporting countries experienced a period of high oil price revenues while they did not yet have the domestic capacity to redistribute wealth in ways other than via subsidies and public employment. The inability to support an international anti- “fossil fuel subsidy” norm in this context seems logical.

The current trend of pricing reforms in the MENA region poses an opportunity to move beyond the debate on subsidy definitions and benchmarks. Somewhat ironically, now that GCC exporters are most interested in domestic reform, on paper, when calculated using the opportunity cost approach, they have lower subsidies than any other moment in the last decade. This shows that the key issue is not necessarily subsidization but rather the domestic valuation of energy. Many GCC countries agree on that issue, and therefore call on the international community to focus more strongly on capacity building, so that energy can be priced more appropriately (Moerenhout, 2017c).



5.0 Conclusion

During the last five years, both exporters and importers have implemented several energy pricing reforms. While most importers started reforms during the high oil price period, most exporters needed reforms more acutely in the wake of the 2014 oil price collapse. While all oil producers in the Arab Gulf experienced fiscal stress due to falling revenues, some have become worse off than others. Reforms were particularly urgent in Oman, Bahrain and Saudi Arabia. Qatar and UAE have also implemented reforms. The reform of in-kind benefits, deficient labour markets and the rise of poverty are three of the most stringent developmental challenges in the GCC region. Reforming one without the others is unlikely to yield satisfying results in the medium term.

- **Energy pricing reform should be understood within a wider context of moving from an allocation state model to a more productive economy.** In-kind benefits and public employment were the dominant mode of welfare distribution across the MENA region. Only when this model was proved fiscally unsustainable did MENA countries implement price increases. Oil exporting countries that are more resilient in terms of finance and resource reserves relative to population size are less incentivized to implement reforms. Pricing reforms are only one step of a complex and painful transition process that is likely to include labour market reform, education reform and social safety net reform.
- **Energy pricing reform is a trend in the MENA region, but not yet the norm.** When oil prices dropped in 2014, a number of importing countries stalled or suspended reforms. It is conceivable that, if oil prices increased again, some exporting countries would do the same. Energy pricing reform may currently be a trend, but that is mostly due to the strong oil price volatility in the last five years. Sustaining energy price reforms will depend on the success of pricing and other reforms, measured not only in fiscal consolidation, but also in tangible economic opportunities and new, better-targeted social safety nets. Focusing on supporting comprehensive reforms is more likely to support pricing reform in the medium term than the effort to create an anti-fossil fuel subsidy norm. This is particularly the case for exporting countries.
- **Providing constructive assistance to MENA pricing reforms means understanding the political complexity of transition processes.** Those providing technical assistance to pricing reforms should not employ normative considerations. Rather, they should accept, as a prerequisite, that the pace of energy pricing reforms is dependent on the gradual adjustment of developmental models. This is true especially for oil exporters in the Gulf. Research, technical assistance and capacity building in the areas of social safety net development, compensation measures, statistical capacity and industrial competitiveness can be particularly helpful to maintain support for pricing reforms in the GCC region. This work has the opportunity to support the transition by locking in reforms already made. All of such assistance should take into account the political reality, rather than aim at “ideal models” from established productive economic models that are simply unachievable in the short term. Rather, it is better to identify regional leaders in various facets of reform and explore pathways to use their knowledge in domestic reforms in other countries.



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