

# STORY 1

## Removing Subsidies for Gasoline and Diesel Consumption in Indonesia

Remove subsidies for fossil fuel consumption

Target support at vulnerable consumers

Support other sustainable development needs

### FEATURED COUNTRY(S)



### INDONESIA

- A lower-middle income, non-OECD country
- Net exporter of gas and coal
- Net importer of oil and oil products

### Key numbers

#### Over USD 300 billion globally

The International Energy Agency (IEA) made this estimate of the total subsidies to fossil fuel consumption in 41 countries in 2017, including fossil-fuel-based electricity, liquid petroleum products, natural gas and coal (Matsumura, & Adam, 2018).

#### Indonesia saved USD 15.6 billion in 2015

This savings was the result of reforms that coincided with falling world oil prices—with savings reinvested in budget increases for key ministries, infrastructure investment by state-owned enterprises and transfers to villages.

### FEATURED REFORM AND ITS PERIOD

- Removal of subsidies for gasoline and diesel in 2014 as part of a shift to a new regulated fuel pricing system

### STAGE OF FOSSIL FUEL LIFE CYCLE

- Consumption

### SECTORS AFFECTED BY REFORM

- Households
- Transport
- Agriculture and fishing

## Context

In 2009, as a member of the G20 and the Asia-Pacific Economic Cooperation, Indonesia committed to reforming its inefficient fossil fuel subsidies. The most wasteful of these were its subsidies for gasoline and diesel. Fuel subsidies, however, seemed to be an intractable issue. Some form of subsidy for fuel had been in place since at least the 1960s (Beaton, Lontoh, & Wai-Poi, 2017). Numerous efforts tried to remove them. In several cases, reforms allowed for the gradual expansion of Indonesia's social protection system, but they also typically constituted one-off price increases, the impact of which was quickly diluted by inflation, growing consumption and rising world oil prices (Beaton et al., 2017). In 2013 gasoline and diesel subsidies were budgeted at USD 9.6 billion and USD 7.0 billion, respectively, amounting to just over 10 per cent of all government expenditure (Lontoh, Beaton, & Clarke, 2015).

### Change in the mechanisms of government support to fossil fuels

In mid-November 2014, the government increased gasoline prices by 31 per cent and diesel by 36 per cent; at the end of December 2014, it announced the complete removal of gasoline subsidies and the introduction of a “fixed price” subsidy on diesel, where the per-litre level of subsidization would remain fixed. For both fuels, the plan was for prices to be frequently adjusted to match international oil price fluctuations.

### Drivers of reform

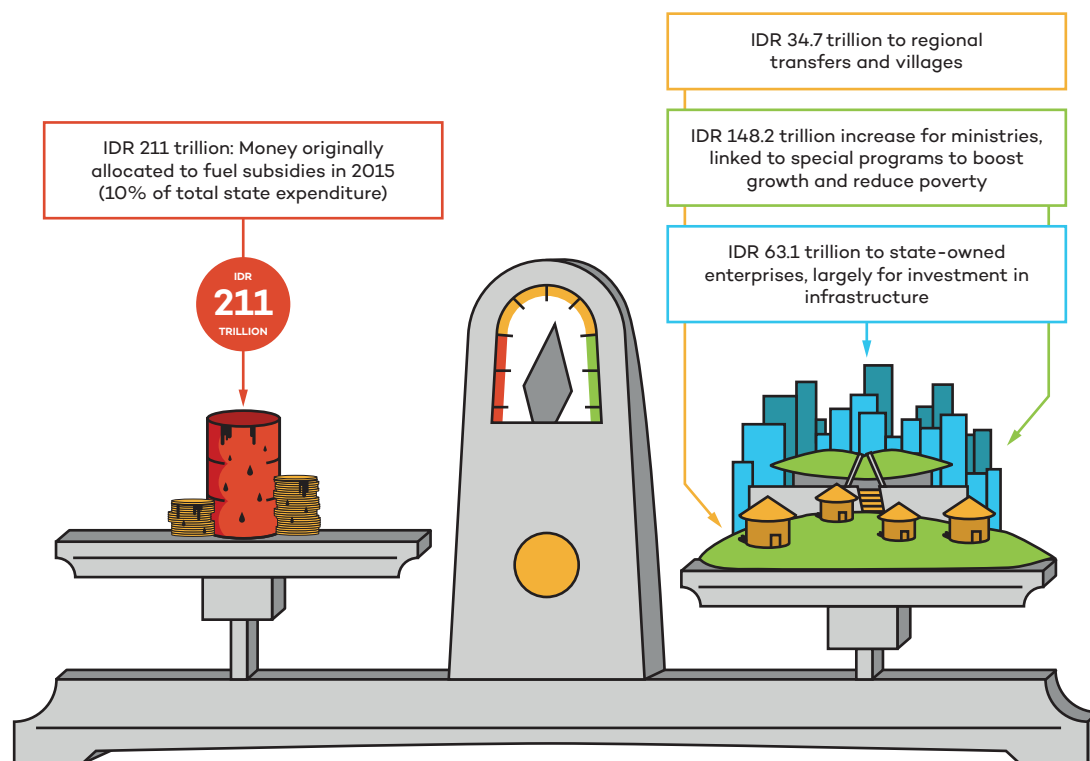
Some drivers had been in place for many years, including the fiscal burden and liability of the subsidies and the enormous opportunity cost of not investing the funds in other areas. Technically, one important driver was the development of social protection systems, such as cash transfers, that could effectively mitigate impacts on the vulnerable. Politically, a key driver was newly elected President Joko Widodo, who had broken precedent by actually promising to reform subsidies during his electoral campaign. This was likely possible due to a subtle shift in public opinion, following years of campaigning and awareness-raising about the subsidy problem, including announcements, television and radio debates, interactive dialogues, banners at fuel stations, print and broadcast advertisements, and cultural performances (Indriyanto, Lontoh, Pusakantara, Siahaan, & Vis-Dunbar, 2013). Public perception may also have been influenced by fuel shortages, which were highly economically and socially disruptive in the months before reform and directly caused by the subsidy scheme (Lontoh et al., 2015). Reform was also affected by external factors. World oil prices fell sharply in 2014, opening up a window of opportunity for reform.

### Complementary policies

Higher energy prices can have significant impacts on poor and vulnerable households, so complementary policies are typically vital in consumer subsidy reform. In the weeks before the first reform, the government launched a social assistance scheme called the Productive Family Program (Program Keluarga Produktif), which introduced smart cards for families with school-age children and for health needs (Beaton et al., 2017). Subsequently, it invested the savings in a wide number of areas intended to bring about economic and social benefits, as summarized below.

# Did the reform generate fiscal or financial space? How was it used?

## Fuel subsidy savings and major increases in expenditure in the revised State Budget 2015



Note: Indonesia did not explicitly link subsidy savings to specific alternative purposes, but these substantial increases in planned expenditure were only possible because of reforms. For full information, see: Pradiptyo, Susanto, Wirotomo, Adisasmita, & Beaton, 2016.

Following reform, the revised state budget estimated savings of USD 15.6 billion from fuel subsidies. There was no formal reallocation of subsidies, but a comparative analysis of the budget before and after reform shows that there were major budget increases in three areas: (1) an additional USD 1.6 billion in transfers to regional governments and villages; (2) an additional USD 12 billion in increased budgets for ministries, including special programs in areas such as health insurance, housing for low-income groups and clean water access; and (3) an additional USD 4.1 billion for state-owned enterprises for investments in infrastructure.

## Wider benefits of the reform

**Socially**, the subsidies were always unfair because they created cost savings for richer households who could afford to buy more fuel: in 2014 the poorest 50 per cent of the population received only 20 per cent of the benefits (Beaton et al., 2017). Conversely, following reform, the government had increased fiscal space to invest in improved and expanded social protection, aimed at those most in need.

**Environmentally**, all things being equal, increasing the price of fuels will decrease unnecessary consumption and incentivize efficiency, reducing the local and global pollution that is linked to fuel use. In Indonesia, consumption of gasoline and diesel in the first half of 2015 fell by 9 per cent and 6 per cent, respectively (Beaton et al., 2017). Detailed analysis has estimated that vehicle trips on toll roads were reduced by 10 per cent following subsidy reforms (Burke, Batsuuri, & Yudhistira, 2017).

## Watching brief

**Missed opportunity:** Indonesia did not increase public investments in sustainable energy despite the fact that its fiscal space increased following the removal of fuel subsidies.

**Ongoing backsliding:** It is clear that the new mechanism has room for improvement, especially with respect to effectiveness in adjusting prices when necessary. The government has not followed its original plan to adjust prices on a regular basis. The last price adjustment for gasoline and diesel took place in early 2016 (Kompas, 2018; Platts, 2018). As of early 2018, with elections approaching in 2019 and oil prices again on the rise, the government has committed to keeping prices stable until the end of 2019. These decisions have effectively reintroduced subsidies (Varagur, 2018). Costs are currently smaller than before but still significant: in June 2018 a government official estimated them at IDR 24 trillion (USD 1.7 billion) over the calendar year (Platts, 2018). These costs have yet to affect fiscal space, because the cost burden is currently borne by state-owned oil company Pertamina, which cross-subsidizes the cost from other profitable parts of its business operations (Primadhyta, 2018)—but if oil prices continue to rise, there are real risks that subsidies will incur direct budgetary costs once again.

**Indonesia's peer review under G20:** In 2017 Indonesia volunteered for a peer review of fossil fuel subsidies under the G20. This review is being undertaken jointly with Italy and is expected to be finalized in 2018 (Gerasimchuk, 2017).

## Other countries in and outside of the G20 that implemented similar reforms:

The reform of consumer fossil fuel subsidies is a highly dynamic policy area. In the last few years, numerous G20 and non-G20 countries have made major progress with consumer subsidy reforms—though major subsidies remain. Leaders in this area include:

- India – deregulated diesel prices in 2014, which had cost USD 10 billion in FY 2013 (Clarke & Sharma, 2014)
- Mexico – gradually deregulated fuel subsidies from 2013 to 2017, reducing oil product subsidies to marginal amounts by 2017 (International Energy Agency, n.d.)
- Saudi Arabia – increases in many energy product prices with cash transfer schemes for the poor (Fattouh, 2018).

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