



**Asia-Pacific  
Economic Cooperation**

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## **Containing Liquid Fuel Price Subsidies in Times of Rising World Oil Prices**

Submitted by: World Bank Group



**Workshop on Potential Options for a  
Voluntary Standstill on Inefficient Fossil  
Fuel Subsidies  
19 August 2021**

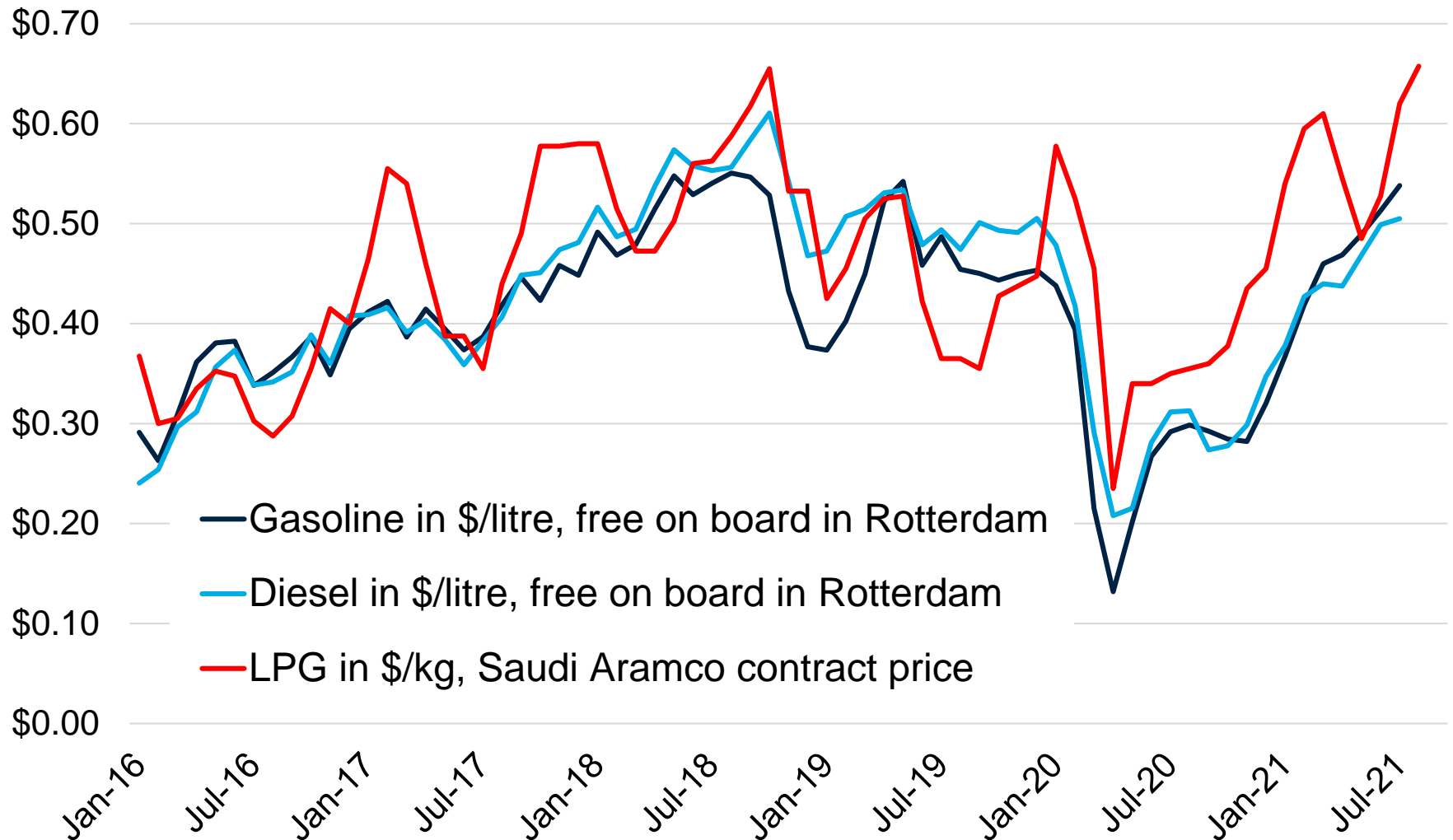


**WORLD BANK GROUP**

# Containing liquid fuel price subsidies in times of rising world oil prices

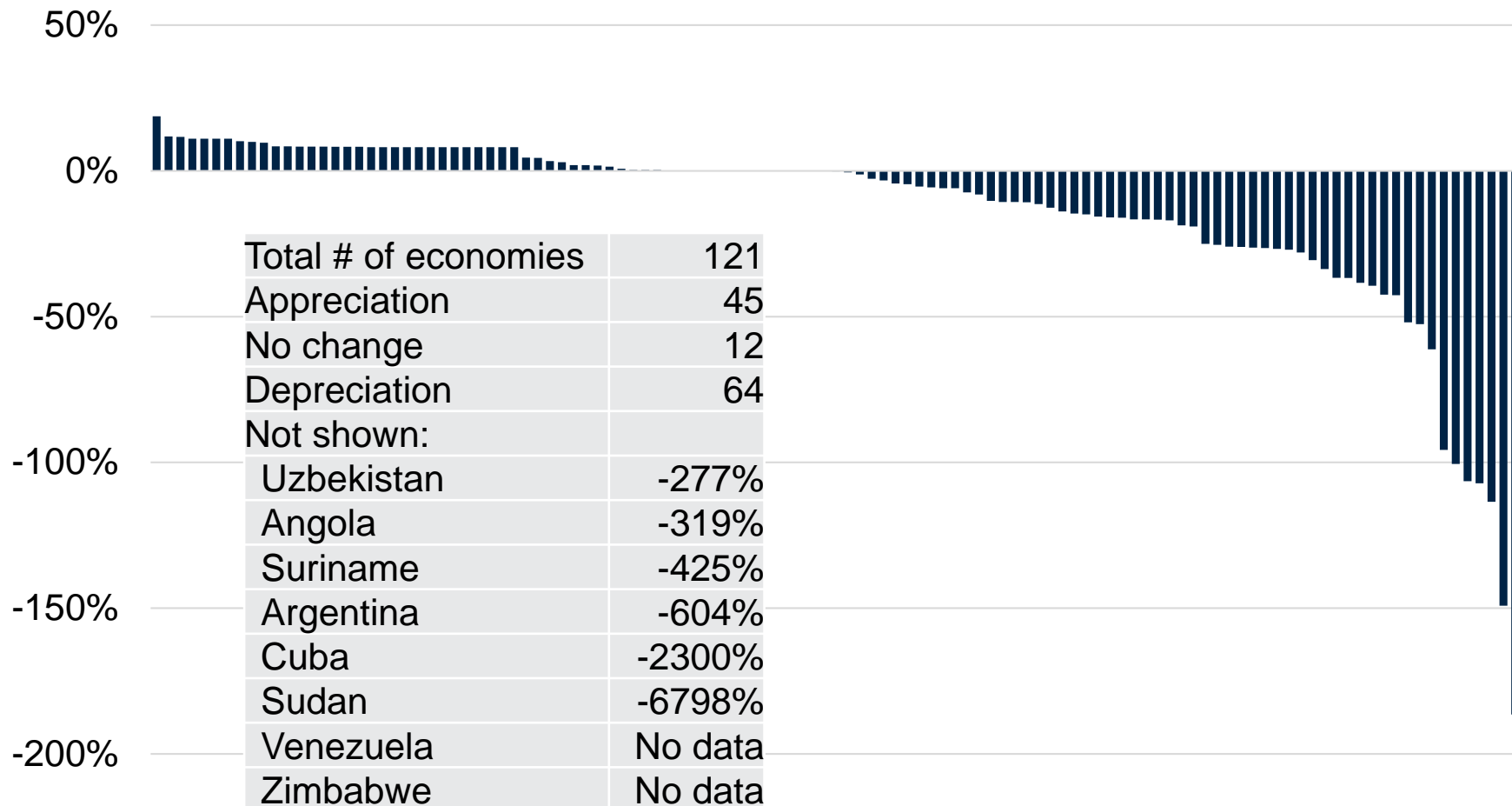
August 19–20, 2021

# International prices have been highly volatile ...



# ... while many developing economies have experienced depreciation against the dollar

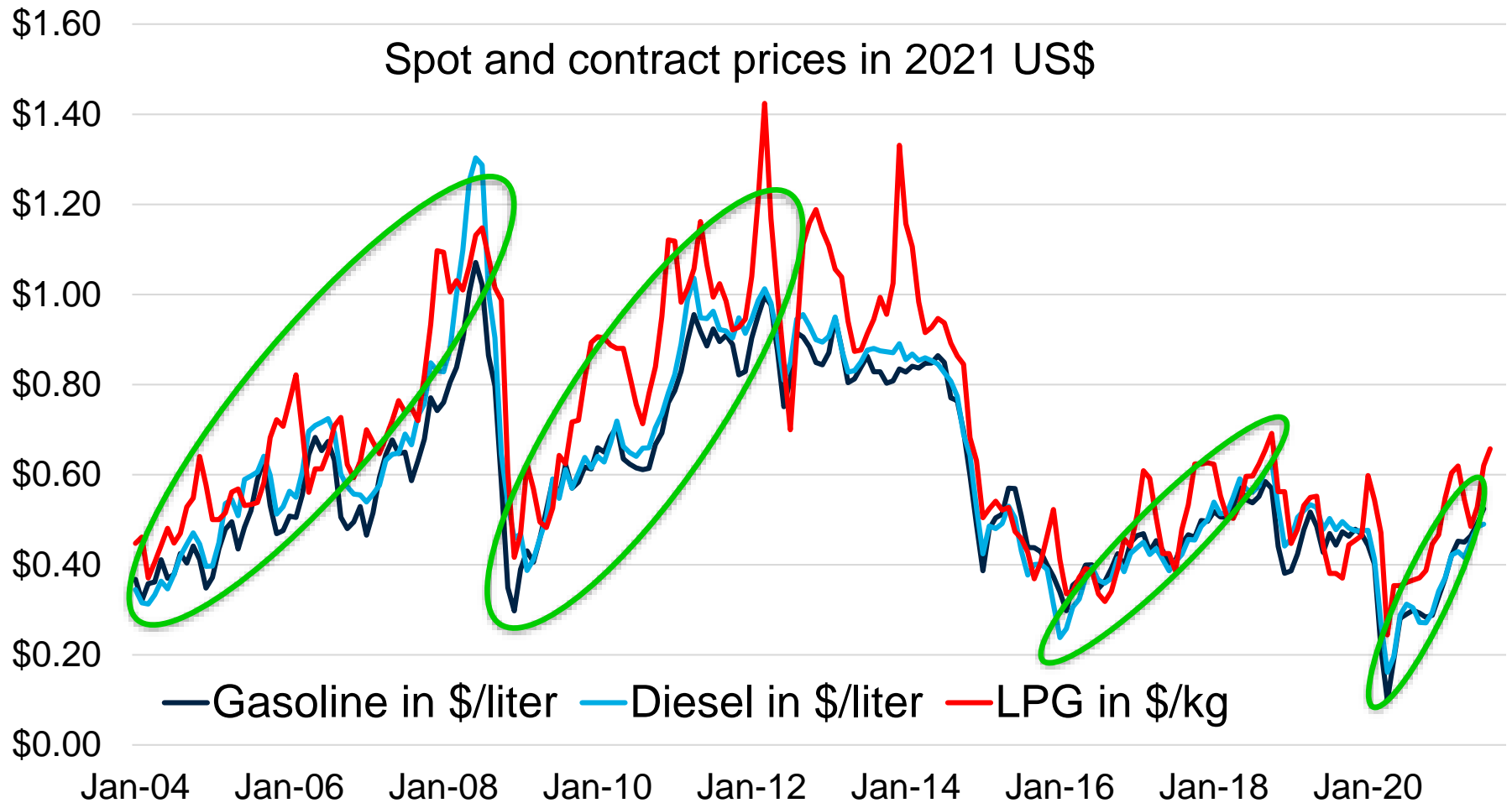
Currency appreciation between Jan 2016 and Jul 2021



In both 2016 and 2020, the oil price collapse was heralded as a golden opportunity to end fuel price subsidies for once and all ...

- The price gap shrank, enabling removal of price subsidies without having to raise prices markedly, if at all.
- Many governments announced an end to price subsidies, although with varying degrees of formality.
- Some eagerly emphasised that market-based pricing even meant falling fuel prices.
- Most did not deregulate pricing but promised regular price reviews and adherence to market-based pricing.
- The political cost was limited to nil, and even negative where prices were lowered.

... but since 2004 low prices have tended to be followed by long periods of rising prices, posing political challenges ...



... and the very reason for the “opportunity” became the driver of policy reversal later

- In a number of economies, the negligible cost of “ending” subsidies was matched by a correspondingly weak commitment to subsidy reform.
- When international oil prices began to rise, policy reversal became all too common.
- Subsidies returned and grew. Doing “nothing” alone resulted in rapidly rising subsidy amounts (on-budget, off-budget, or both):
  - The price gap for each fuel grew due to rising world prices, exacerbated by currency depreciation in many (Nigeria on next slide).
  - Smuggling became even more lucrative, increasing “apparent” consumption and hence the total subsidy amounts.

# Nigeria in 2016 and again in 2020 initiated gasoline price subsidy removal ...

- Nigeria is the only economy that subsidises only gasoline and no other liquid fuel.
- In May 2016 the government raised the uniform gasoline price from ₦87 per litre to a price band of ₦135–145 and announced a pricing mechanism based strictly on international price movements.
- The government could not honour the commitment when the currency depreciated by 60% later in 2016.
- In March 2020, the government issued a new pricing regulation, ending the price subsidy and again committing to a pricing mechanism based on international price movements.



# ... but pressure from labour led to a clear policy reversal by December 2020

- After lowering gasoline prices in Mar, the government increased them in Jul, Aug, Sep and Nov 2020.
- Against the backdrop of rising international prices and currency depreciation, the government lowered gasoline prices in Dec under pressure from labour and has frozen prices since.

Price gap in ₦/litre

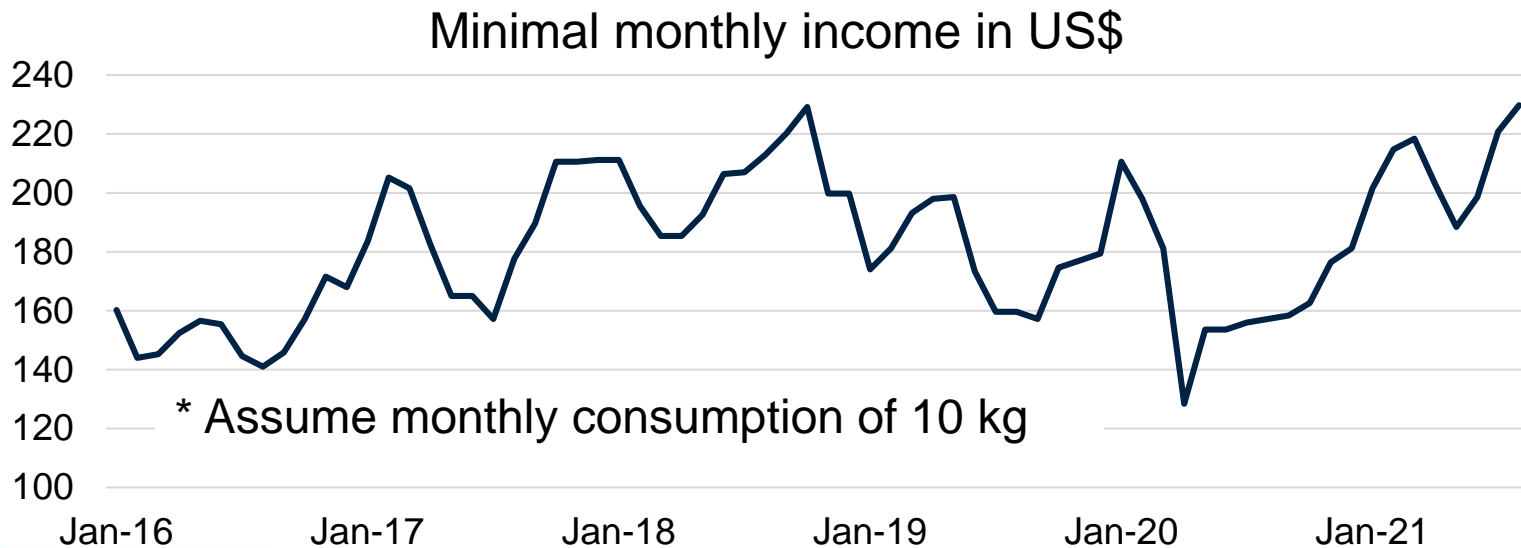


# LPG pricing reform is especially challenging ...

- LPG is a fuel of the better-off in urban areas in low- and lower-middle-income economies when unsubsidised.
- LPG has been promoted by many governments, first to slow down deforestation and in the last 2 decades to reduce indoor air pollution, which kills 4 million people a year.
- International experience points to a need for very large unit price subsidies to help the poor adopt and use LPG regularly. Helping with initial adoption alone is insufficient.
- Adoption of a clean gaseous fuel is not the same as abandonment of polluting solid fuels, needed to protect public health.
- No government can subsidise its way out of the problem of household air pollution and there are no obvious effective alternatives.

## ... and the problems are compounded by even higher price volatility

- A very efficient market may be able to deliver bottled LPG to end-users at an additional cost of \$0.3/kg to spot or contract prices.
- A basic rule of thumb is that if a fuel costs more than 5% of total household expenditure it is not affordable.
- The minimal income threshold needed to make LPG affordable has varied by nearly two-fold since Jan 2020.



# To reduce the price gap, one option is to increase the price by the same amount at fixed intervals...

## Benefits

- Increases are predictable, so consumers can plan ahead.
- There is no discretion or calculations involved because the amount is fixed.
- Each increase is relatively small, the opposite of a shock therapy, and makes it easier for households to adapt.
- Consumers get used to prices changing frequently rather than prices that are frozen for months on end.

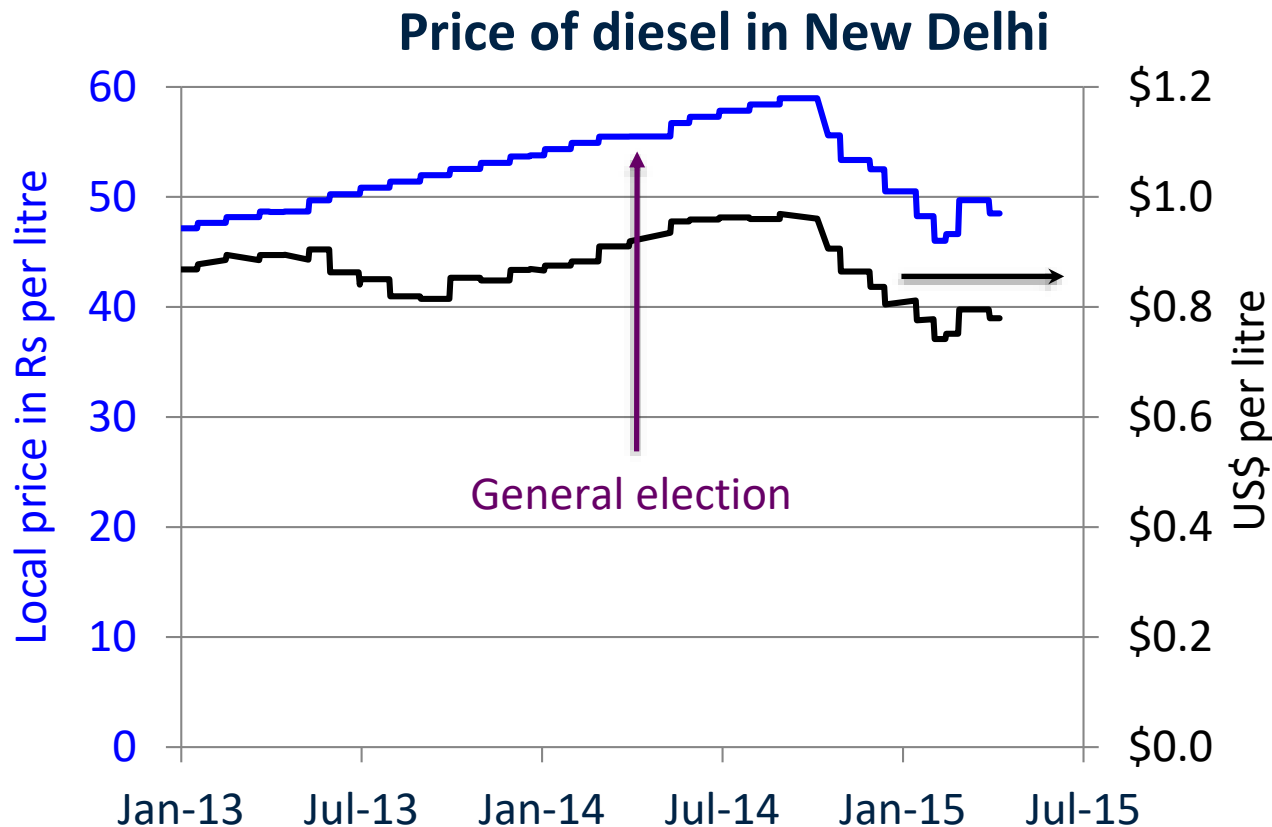
## Potential issues

- The political will to carry on month after month could be lost.
- People may “hoard” ahead of each price increase, creating fuel shortages.
- Inflation can outstrip the price increase if set too low.

... as successfully implemented in India in 2013–14

India increased the price of diesel by Rs 0.5 per litre every month until the price gap was eliminated, after which the

retail prices followed international diesel fuel price movements.



# Closing observations

- Fuel subsidy reform usually does not have an end and instead is a continuing journey. Too many “successes” have been celebrated prematurely.
- Rising trade-parity prices in local currency over a prolonged period arguably present the greatest political challenge.
- The more formal the commitment to reform and the more frequent the price adjustments, the better the chances of reform durability.
- Where households account for a large share of consumption, such as with LPG, pricing reforms are all the more politically challenging. It is important to recognize the distributional impact of subsidies aimed at ending use of polluting fuels (benefitting the non-poor, if not the better-off) vs. increasing adoption, however infrequent the use (benefitting some poor). Either way, targeting subsidy delivery is essential.