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Subsidies on Basic Goods in the Arab Region

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Dr. Naser served as a research director and fellow at Palestine Institute of Economic policies Research in Ramallah over the period of 2009-2011. He served as a consultant and advisor for many local and international organizations including the World Bank, UNDP, ESCWA, ILO, EUC-Jerusalem, GIZ, FES, Palestine Monetary Authority, Palestine Investment Fund and others.

Dr. Naser has attended and presented tens of research papers in local and international conferences and workshops. He also published tens of research articles in refereed academic journals in the area of development, economic policies, fiscal policy, corporate governance and financial markets.

Introduction

Report Objectives

The report aims to explore current subsidies offered by Arab States to their citizens and basic goods subsidized. The report also attempts to identify recent shifts in subsidies and, more specifically, to answer the following questions:

- Which subsidy reforms were recently adopted by Arab governments?
- What are the factors influencing the adoption of said reforms, and to which extent are they aligned with the particularities of Arab societies?
- What role do the International Monetary Fund (IMF) and IMF strategy play in the adoption of subsidy reduction reforms, and what are the relevant rationale and arguments?
- Is subsidy reduction economically and socially viable?

Methodology

This report follows a descriptive methodology in which the author reviews previous documents and reports on the topic and presents secondary data published by competent bodies and institutions in charge of observing relevant financial and economic data. Finally, a series of focused and targeted questions were designed for a number of institutions in target countries in order to achieve a better and more precise understanding of the subsidy issue in the Arab region.

Report Themes

The framework of this report sheds light on five key themes:

Theme I includes a review of previous studies and reports on the topic, drawing findings on the experiences of targeted countries in this regard. This theme also highlights success areas and factors influencing success and failure, and presents the arguments and rationale of those supporting and opposing government subsidies.

Theme II aims to offer a view on government subsidies on basic goods in target countries, including the type of subsidies offered, target sectors, and beneficiaries, and identifies key shifts in subsidies.

Theme III offers a review of the IMF's views on the reduction of government subsidies, underlining key motives and justifications behind the IMF's recommendation to reduce subsidies. This section also explores the perks and drawbacks of acting on this recommendation, leveraging examples of countries that succeeded and benefited from adopting this approach.

Theme IV looks into the impact of subsidy reduction, specifically its impact on beneficiaries, as well as the economic, political and social outcomes and repercussions of subsidy reforms.

Theme V offers recommendations to decision makers in target countries with the aim of improving general and social performance and subsidy management mechanisms. This includes suggestions to help avoid previous mistakes and proposed mechanisms to enhance subsidy efficiency in spite of reduction and limited benefits.

Literature Review

Many studies have tackled the reality of government subsidies on basic goods in several Arab States in order to identify their impact on said States and take the necessary corrective measures in light of significant challenges facing most Arab States on all political, economic, and social levels. The below literature review will define government subsidies, subsidy types, objectives and impact on national economies with a special focus on Arab States.

What are government subsidies on goods and services?

Several studies exist on government subsidies, examining subsidy forms and impacts, and using different definitions and interpretation of the concept. A study conducted by Schwartz (1999) defines subsidy as "any government assistance that allows consumers to purchase goods and services at prices lower than those offered by a perfectly competitive private sector, or raises producers' incomes beyond those that would be earned without this intervention. Under this definition, subsidies to consumers include cases where the government, as a producer of goods and services, sells its output at a price that does not reflect all costs, […] or compensates the private sector for doing so." This definition is aligned with that offered in a study by Mostafa (2016), in which she defines government subsidies as government allocations to producers with the aim of encouraging exports and influencing demand in general, or government allocations to consumers to improve their quality of life, or, in other words, a tax borne by the government.

This same study also defined government subsidies as a form of assistance provided by the government to decrease the production costs of certain goods, thus decreasing their selling price for the consumer. This definition implicates a fairly large set of government policies, including goods and services offered directly to citizens below cost, differential tax treatment on certain goods and services, and government regulations indirectly reducing production costs of certain goods and services.

Forms of Government Subsidies

Government subsidies differ according to economic circumstances of each country and generally include the following: (1) subsidies on basic commodities, petrol products, electricity, pharmaceuticals or water; (2) subsidies on certain services, e.g. subsidies on public transportation; (3) government subsidies for development goals, e.g. facilitated loans, social housing; and (4) subsidies on certain economic activities, e.g. subsidies on industrial zones, to farmers, and subsidies aiming at promoting exports. Schwartz (1999) divides subsidy forms into the following categories:
(1) *credit subsidies* through low-interest loans;
(2) *tax subsidies* through the reduction of specific tax liabilities;
(3) *equity subsidies* in the form of government equity participations;
(4) *in-kind subsidies* through government provision of goods and services at below-market prices;
(5) *cash subsidies* to producers or consumers;
(6) *procurement subsidies* through government purchases of goods and services at above-market prices;
(7) *regulatory subsidies* in the form of implicit payments through government regulatory actions that alter market prices.

Government Subsidies in Arab States

The MENA region presents the highest levels of government subsidies in the world, namely energy subsidies, which reached 8.5% of the region's GDP in 2011, i.e. USD 240 Bn (Zayed et al., 2014). Energy subsidy expenditures represented 9.3% of Egypt's GDP in 2010, 9.8% of KSA's GDP, and 13.8% of Iraq's GDP. A study on government subsidy policies in Arab States (Ismail, 2018) tackled the reality and size of subsidies in Arab States, which witnessed a significant increase in the past decade due to the increase in the prices of many goods and services, especially imported goods, leading to increased government subsidies and goods and services covered. These subsidies have however decreased recently. In fact, cash subsidies included in the State's general budget and covering food, commodities, electricity, petrol products, housing programs and government institution benefits witnessed a substantial drop in 2013-2016. Existing data on Egypt, Morocco, Oman, Jordan, Bahrain, UAE and Lebanon indicate a decrease in cash subsidies from total government expenditures in all the aforementioned States from 8.5% in 2013 to 4.6% in 2016. Given the recession witnessed in each of these countries, the share of cash government subsidies from GDP dropped from 29% in 2013 to 17% in 2016 in Egypt, 11.4% to 2.8% in Oman, 4.8% to 3% in Jordan, 2.9% to 2.6% in Bahrain, and 2.7% to 2% in the UAE for the same period. As for Lebanon, the share of government subsidies from total government expenditures dropped from 0.4% in 2013 to 0.2% in 2015. This overall drop is the result of a decrease in government subsidies on imported petrol products and electricity, as well as the mild decrease in subsidies on food and basic commodities due to reform policies adopted by many of these countries.

This study focused on government subsidies on energy products, i.e. petrol products and electricity, and concluded that energy subsidies in Arab States were estimated at USD 117 Bn in 2015, almost a quarter of the world's total energy subsidies and 3% of Arab States GDP, noting that energy subsidies in Arab States constituted half of the world's energy subsidies back in 2011.

The study also explored the different types of government subsidies in Arab States according to different considerations and classifications leveraged by each State to determine subsidized goods and services. When it comes to energy product subsidies, some countries reduced its subsidies on certain products, while others ended these subsidies. Jordan, the UAE, Oman, Lebanon, Morocco and Mauritania lifted subsidies on petrol products. Jordan, Lebanon and Qatar lifted subsidies on natural gas, while Lebanon and Mauritania lifted subsidies on electricity. Meanwhile, Palestine, Jordan, Qatar, Kuwait Iraq and other countries have maintained electricity subsidies. As for subsidies on food commodities, the situation differs by counatry. Jordan, for example, subsidizes wheat and its derivatives, rice, sugar, infant formula, and cooking oil, while Oman only subsidizes rice and sugar. The study also tackled differences in subsidies on social services, e.g. housing, potable water, transportation, higher education, healthcare and pharmaceuticals among different countries. It appeared that Lebanon subsidizes housing, education

and healthcare but does not subsidize transportation, while the government in Palestine only subsidizes transportation. The study also covered agricultural, livestock and industrial production subsidy policies adopted by many Arab States to promote and develop local production. The study also focused on subsidy mechanisms and forms in Arab States, including price reduction, tax and custom duty reduction (e.g. Jordan and Lebanon), and loan interest reduction through housing and agricultural production subsidies for example.

Impact of Government Subsidies

Practically speaking, subsidies are often ineffective, in the sense that they fail to benefit targeted segments, and costly given their negative impact on welfare and social justice, regardless of whether they directly impact public expenditures (e.g. cash subsidies or implicit subsidies included under other expenditures or offered through semi-financial operations) or not (e.g. tax or regulatory subsidies). Subsidies on social services often clearly exceed the explicit or apparent cost included in the general financial budget. Subsidies also often lead to an overproduction of subsidized goods (Schwartz, 1999).

Many studies looked into the impact of government subsidy reforms in the MENA region using the Computable General Equilibrium (CGE) model (Gharibnavaz and Waschik ,2015), (Jensen and Tarr, 2003), (Karim et al., 2012) and (Manzoor et al., 2012). These studies concluded that target reforms can lead to a significant improvement in welfare, especially for low-income households. The studies also found that energy subsidy reforms lead to a higher improvement in welfare than food subsidy reforms given that energy subsidies are much higher than food subsidies. A study by Cockburn et al. (2014) showed that lifting energy subsidies in Egypt and Jordan is not enough to compensate for potential repercussions. A study by Adams and Roos (2014) used the dynamic CGE model for the case of Jordan to assess the impact of lifting subsidies on food, gas, water, electricity, education and healthcare. The results showed a short-term drop in employment due to the increase in the actual cost of labor, which in turn is due to lifting electricity subsidies leading to increased spending compared to production cost. As a result, producers decrease employment and resort to less costly alternatives such as capital. Adams and Roos also underline in their study that all the benefits of efficiency improvement to private consumers are reflected as an actual increase in income. As such, actual private consumption increases even after an increase in prices paid by household for electricity is authorized. Another study by Abou Alainain et al. (2009) assesses the short and mid-term impact of a gradual lift of energy subsidies in Egypt. Study results show a drop in overall private consumption and actual GDP in the absence of payments made to households. The key driver of this result is the increase in energy prices leading to an increase in the prices of consumer goods and in production costs. All household groups studied demonstrated a decrease in welfare levels, with 1/5 of the wealthiest households showing the highest response. This is due to the fact that the wealthiest households consume a larger share of subsidized energy products than low-income households. Reducing energy subsidies and

allocating cash subsidies to the poor rather than the wealthy would therefore lead to improved income distribution measures.

The International Monetary Fund's View on Government Subsidies in the Arab Region

The International Monetary Fund (IMF) believes that lifting subsidies is the key to controlling public finances and reducing debt, and enables States to achieve comprehensive private sector-driven economic growth and sustainable development. The IMF also imposed on countries benefiting from loan agreements, e.g. Jordan, Tunisia, Morocco, Egypt and Yemen a clause stipulating the requirement to implement strict financial austerity measures, i.e. reducing food and energy subsidies in order to benefit from said loans.

Implementing the IMF's recommendation on lifting government subsidies on goods and services did not achieve considerable success in MENA countries, which is partly due to the failure of public policies in these States to alleviate the increasing financial burden on the poor and middle class. In fact, the implementation of reform policies sparked violent popular reactions and economic turmoil, negatively impacting State stability. In Jordan, the government's attempt to reduce subsidies on certain goods in 1989 and 1996 led to widespread riots and protests across Jordanian governorates. Reform policies implemented by both the Jordanian and Egyptian government in 2011 and 2012 respectively through the reduction of government subsidies were also met with massive popular objection. In Sudan, the reduction of fuel subsidies in September 2013 sparked violent protests and subsequent clashes with security forces, leading to more than 50 casualties.

Lifting subsidies cannot be the magic bullet to the massive financial and budgetary difficulties facing most Arab states. Considering the increasing social issues and economic fluctuations across Arab countries, the IMF is increasingly calling for a gradual rather than immediate lift of subsidies. Given that subsidy reduction directly affects the purchase power of low-income households and individuals, the IMF suggests expanding social protection networks as a means of compensation for the repercussions of lifting subsidies on the poor. Practically speaking, however, social protection systems in Arab States, if any, are fragile, and therefore incapable of protecting the poor from price increases.

These recommendations are yet to assess the impact of subsidy reduction on poverty rates, middle class living conditions, and local consumptions. In fact, lifting subsidies could lead to decreased wages, reduced citizen purchase power and participation in local markets, and put the living conditions of vulnerable segments at risk. Subsidy reforms should only be applied after developing sustainable and comprehensive social protection plans, and can only be maintained through the wide support of various stakeholders. Rather than calling for a gradual lift of energy subsidies, the IMF should adapt its recommendations to the particular circumstances of each country, taking into

account the need for effective and actionable social protection plans.

The IMF insisted on the necessity of structural adaptation programs (SAPs) for Arab governments, namely including financial austerity measures, e.g. reducing debt and spending and lifting subsidies. These policies, however, led to an increase in poverty rates and unemployment, and a decrease in wages in the region. The IMF describes food and energy subsidies as policy tools that exacerbate financial imbalances, promote excessive energy consumption, reduce investments in renewable energy, and divert public spending on key social programs such as healthcare and education.

The IMF praised Iran's subsidy reforms in 2010 and the implementation of comprehensive monetary programs. Nonetheless, these measures led to a recession in certain economic activities, increased inflation, and undermined political support to such a strategy. While subsidy reforms in the Arab region could have macroeconomic benefits, poor economic performance indicators in Arab States are rooted in both their political economies and production structures, and go beyond the IMF's suggestion to adopt short and mid-term austerity measures and energy subsidy lift. The IMF's approach targets financial debts symptoms in Arab governments without treating the causes of rooted social and economic injustice which sparked Arab uprisings.

Rectifying the course of poor financial conditions in Arab States cannot be achieved without fundamental changes in economic production structures by shifting into developmental countries and building effective institutions having economic and social development as a priority objective. Arab governments should therefore reconsider their policy choices on promoting manufacturing activities and building industrial capacities. This would generate a skilled workforce, drive productivity, and create links with other sectors, reducing the need for government subsidies burdening Arab governments. Nonetheless, any choice of reform strategy should be a medium to long-term effort, and should be coupled with a comprehensive rights-based social protection framework, taking into consideration current poverty rates in the country in question.

Subsidies come in many forms, and can be summarized into the following:

- **Food and basic commodities**
- **Energy (electricity and petrol products)**
- **Housing programs (affordable housing)**
- **Producer and exporter subsidies**
- **Free education and healthcare services**

Many segments benefit from government subsidies, mainly:

- **Low-income households (through direct subsidies on energy, food, medication, housing, healthcare and education)**
- **Consumers (through different indirect subsidies to producers to reduce production costs)**
- **Producers (through subsidies on production elements and equipment costs, whether directly through reduced prices or indirectly through exemptions and benefits offered to producers and investors in specific sectors)**
- **The general public (through the expansion of the base of beneficiaries from social welfare achieved through subsidies offered, increased citizen purchase power, and subsequent enhanced ability to meet their needs)**

Subsidies on Basic Commodities in the Arab Region (Figures and Indicators)

This section covers the reality of government subsidies in certain Arab States and the changes that occurred in this regard, according to IMF[1] and AMF[2] data. The section also covers subsidies provided by each State, with a special focus on energy subsidies in their different forms and changes implemented by each State in light of adopted economic reform policies according to the economic situation of each country. In terms of cash subsidies on basic commodities, these countries subsidize food products to alleviate the burden of living costs for low-income citizens, with food subsidies being included in 75% of Arab State budgets. The cost of food subsidies is, however, low compared to other types of subsidies, accounting for 1% of GDP in 9 Arab States.[3] Non-cash subsidies cover all goods and services for which the State waves a share of public resources to reduce their financial cost to below supply and distribution cost. This includes energy subsidies, i.e. electricity subsidies and subsidies on other petrol products. Energy subsidies in the Arab region was estimated to account for a quarter of global energy subsidies in 2015, in a drop from accounting for half of global energy subsidies back in 2011. Subsidy forms and mechanisms also vary in each State; some adopt a direct price reduction policy to subsidize the consumption of certain goods and services, others reduce taxes and fees to reduce the prices of consumer goods, promote production and enhance competitiveness, and others reduce interest rates on loans dedicated to low-income households, as well as housing and agricultural production subsidies.

Egypt

Data presented in Table 1. indicates that the share of subsidies from national GDP was unstable in 2005-2015. In fact, the share of subsidies increased from 2.4% in 2005 to 9.2% in 2013 while experiencing some fluctuations throughout this period, to drop again in the two following and reach 6.1% in 2015. This fluctuation is also visible in the share of subsidies from government expenditures which increased from 12% in 2005 to 31.2% in 2013, to then witness a sharp drop, reaching 22.4% in 2015.

Cash subsidies in Egypt, i.e. subsidies on food, commodities, electricity, petrol products, housing programs and public institution allocations account for a large share of government expenditures compared to other countries. This share dropped from 29% in 2013 to 17% in 2016. Subsidies on basic commodities account for 0.3% of government expenditures and has not witnessed a considerable drop given its already minimal share. The share of subsidies to government institutions from total government expenditures did, however, increase from 3.1% in 2013 to 5.5% in 2016. The State of Egypt also subsidizes all energy products, including electricity and other petrol products. Egypt's subsidies on basic food

Table.1: Share of Expenditures and Subsidies from National GDP and Share of Subsidies from Government Expenditures in Egypt

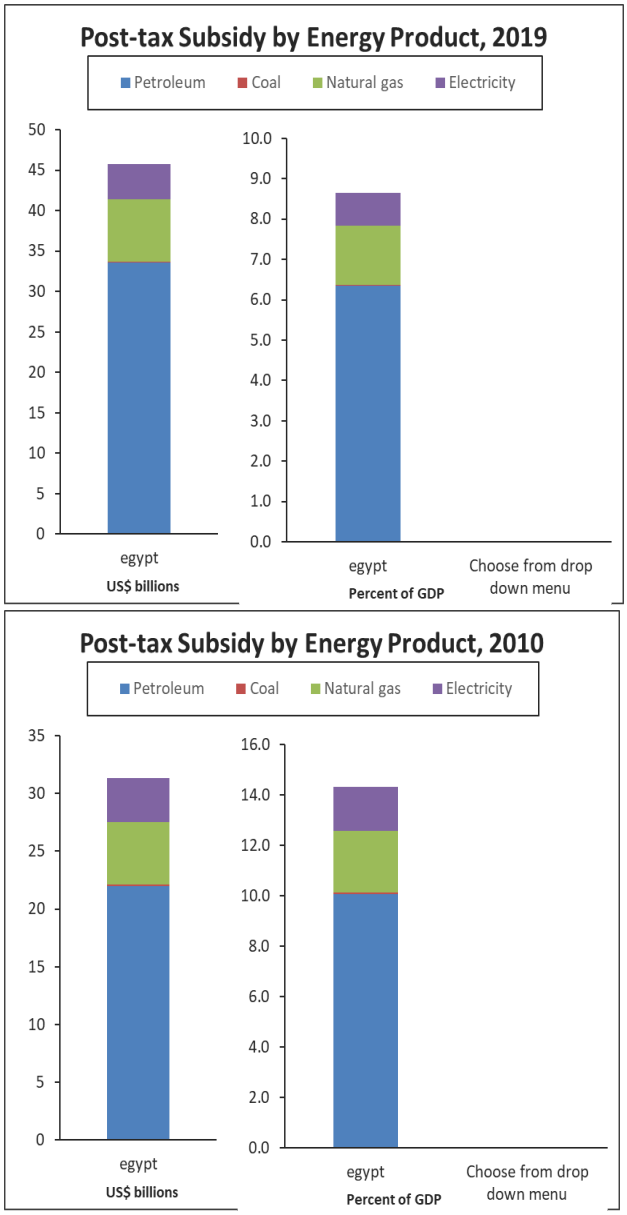
Year	% of Expenditures from GDP	% of Subsidies from GDP	% of Subsidies from Expenditures
2005	20.2	2.4	12.0
2006	25.5	8.4	32.7
2007	22.9	6.9	30.3
2008	26.3	9.0	34.0
2009	28.1	8.6	30.5
2010	25.0	7.4	29.6
2011	25.1	7.7	30.9
2012	26.0	8.1	31.0
2013	29.5	9.2	31.2
2014	30.5	8.8	28.9
2015	27.5	6.1	22.4

Source: IMF website, published data.

products cover wheat and its derivatives, rice, sugar, infant formula, and cooking oil. As for social services, the State of Egypt subsidizes housing, potable water, transportation and healthcare, including human medication. To support agricultural, livestock and industrial production, Egypt provides subsidies on fertilizers and exports of local production. Egypt also adopts a price reduction policy on petrol products, subsidizes housing loans, finances low-income households, and subsidizes agricultural production loans.

In 2010, energy subsidies in Egypt amounted to USD 31.2 Bn in Egypt, accounting for 14.3% of GDP and reaching USD 396.5 per capita. Electricity subsidies amounted to USD 3.8 Bn at 1.7% of GDP and USD 48.4 per capita. Natural gas subsidies amounted to USD 4.5 Bn at 2.5% of GDP and USD 68.6 per capita. Petrol subsidies amounted to USD 22 Bn at 10.1% of GDP and USD 279.5 per capita. In 2019, energy subsidies in Egypt amounted to USD 45.6 Bn and accounted for 8.6% of GDP, with subsidies per capita reaching USD 476.5. Electricity subsidies amounted to USD 4.29 Bn at 0.8% of GDP and USD 44.8 per capita. Natural gas subsidies amounted to USD 7.7 Bn at 1.46% of GDP and USD 80.8 per capita. Petrol subsidies amounted to USD 33.6 Bn at 6.35% of GDP and USD 350.9 per capita.

Figure 1: Post-Tax Energy Subsidies and % of GDP in Egypt in 2010-2019



Source: International Monetary Fund, Energy Subsidies Template. [4]

Lebanon

Data presented in Table 2.2 indicate that the share of subsidies from national GDP has witnessed many fluctuations in 2005-2019, increasing from 2.7% in 2005 to almost the double in 2008, to then decrease slightly in the coming years, reaching a low 2% in 2016. Subsidies then increased again to reach 3.2% in 2019. This also applies to the share of subsidies from government expenditures, which increased from 10% in 2005 to 18.2% in 2008, then increased again to reach 20.3% in 2012, to drop to 7.9% in 2016, and finally 10.7% in 2019.

Table 2: Share of Expenditures and Subsidies from National GDP and Share of Subsidies from Government Expenditures in Lebanon in 2005-2019

Year	% of Expenditures from GDP	% of Subsidies from GDP	% of Subsidies from Expenditures
2005	26.8	2.7	10.0
2006	31.7	3.7	11.6
2007	31.6	4.0	12.7
2008	30.5	5.5	18.2
2009	28.8	4.3	15.0
2010	25.8	3.3	12.6
2011	26.4	4.6	17.4
2012	26.8	5.4	20.3
2013	26.7	4.6	17.4
2014	25.9	4.6	17.8
2015	22.9	2.7	12.0
2016	25.8	2.0	7.9
2017	25.9	2.7	10.3
2018	29.3	3.4	11.5
2019	29.6	3.2	10.7

Source: IMF website, published data.

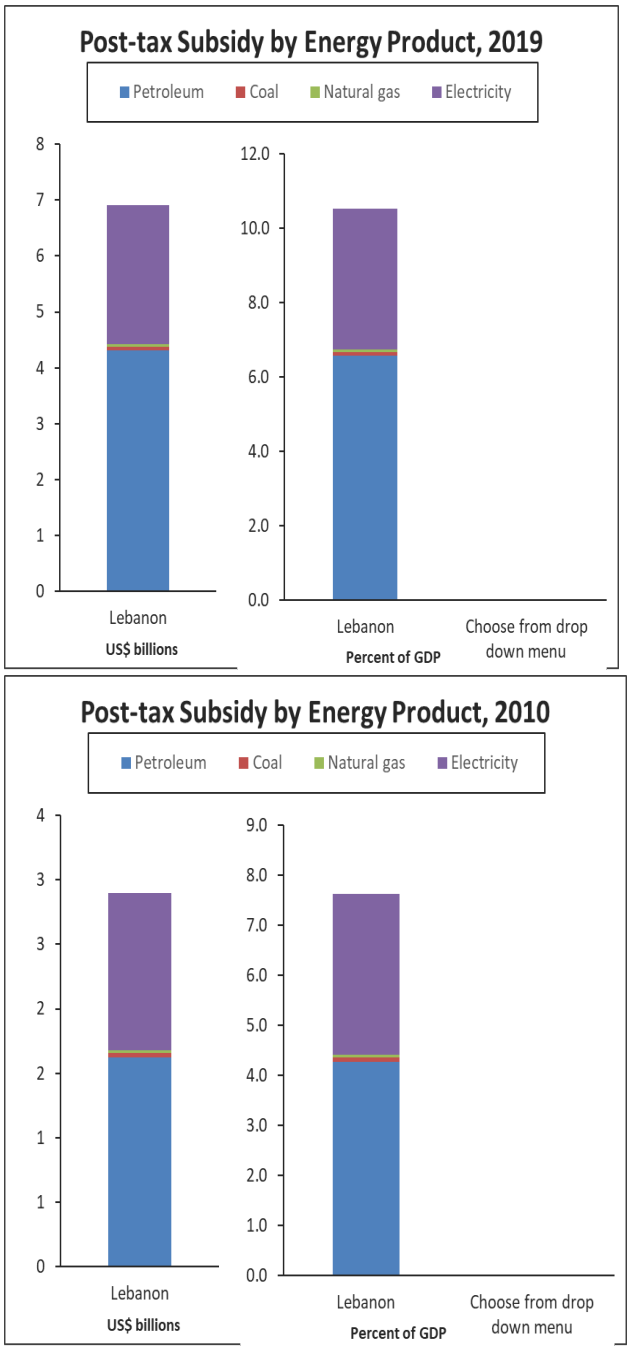
The share of cash subsidies from government expenditures in Lebanon dropped from 0.4% in 2013 to 0.2% in 2015. Subsidies on basic commodities account for 0.4% of government expenditures and did not experience any significant drop given their already minimal share. Subsidies in Lebanon include tax reductions on basic food products such as rice, sugar, infant formula, and cooking oil. Subsidies on social services cover higher education and healthcare services including human medication, but exclude potable water and transportation services. As for agricultural, livestock and industrial production, the State of Lebanon subsidizes agricultural exports, agricultural product prices, fertilizers, irrigation water, animal feed, veterinary medication, industrial production materials, and local production exports. The State of Lebanon also offers subsidies to government service

institutions as well as housing subsidies by subsidizing loan interests through the Public Corporation for Housing (PCH).[5]

In 2010, energy subsidies in Lebanon amounted to USD 2.86 Bn at 7.5% of GDP and USD 659.4 per capita. Electricity subsidies amounted to USD 1.22 Bn at 3.2% of GDP and USD 281.14 per capita. Natural gas subsidies amounted to USD 0.02 Bn at 0.05% of GDP and USD 4.67 per capita. Petrol subsidies amounted to USD 1.6 Bn at 4.27% of GDP and USD 373.54 per capita. In 2019, energy subsidies reached USD 6.8 Bn at 10.4% of GDP and USD 1443.6 per capita. USD 2.48 Bn were allocated to electricity at 3.78% of GDP and USD 524.3 per capita, USD 0.04 to natural gas at 0.06% of GDP and USD 8.7 per capita, USD 4.3 Bn to petrol at 6.56% of GDP and USD 910.7 per capita.

The first signs of a devastating economic crisis in Lebanon emerged through the drop in the country's foreign cash reserves from an average of USD 30 Bn at the beginning of 2020 down to USD 16 Bn. According to the central bank, the subsidy policy is the key driver of this drop. As such, the central bank issued a decision to adopt the USD to LBP exchange according to its actual rate in the (black) market which evidently exceeds the official exchange rate adopted by the central bank for the past 20 years by far. This difference in exchange rate was the mechanism through which basic goods were being subsidized. Due to the lack of foreign cash dedicated to imports, the Lebanese economy witnessed a significant increase in the prices of fuel and other basic goods, with inflation exceeding 144% (357% on transportation, 281% on food products) in September.[7] The crisis also led to a clear shortage in the inflow of basic goods (e.g. fuel, commodities, medication).[8]

Figure 2: Post-Tax Energy Subsidies and % of GDP in Lebanon in 2010-2019



Source: International Monetary Fund, Energy Subsidies Template. [6]

Jordan

Data presented in Table 2.3 indicate that the share of subsidies from national GDP were below 1% up until 2007, then witnessed a sharp increase, reaching 3.3% in 2008 and 4.5% in 2011 and 2012. In the past few years, the share of subsidies from GDP varied between 1.1% and 2%, reaching 1.6% in 2019. Subsidies also account for a rather small share of government expenditures. In fact, subsidies accounted for less than 1% before reaching 10.7% in 2008, then witnessed a few fluctuations, reaching 15.7% in 2011 and dropping down to 6.2% in 2019.

Table 3: Share of Expenditures and Subsidies from National GDP and Share of Subsidies from Government Expenditures in Jordan

Year	% of Expenditures from GDP	% of Subsidies from GDP	% of Subsidies from Expenditures
2005	34.6	0.9	2.6
2006	31.8	0.3	0.9
2007	32.9	0.2	0.5
2008	30.5	3.3	10.7
2009	29.2	1.5	5.1
2010	26.2	1.6	5.9
2011	28.8	4.5	15.7
2012	28.9	4.3	14.8
2013	26.2	1.4	5.3
2014	27.5	1.1	4.1
2015	25.7	1.1	4.1
2016	25.9	1.5	5.8
2017	25.7	1.8	6.9
2018	26.6	2.0	7.7
2019	26.2	1.6	**6.2**

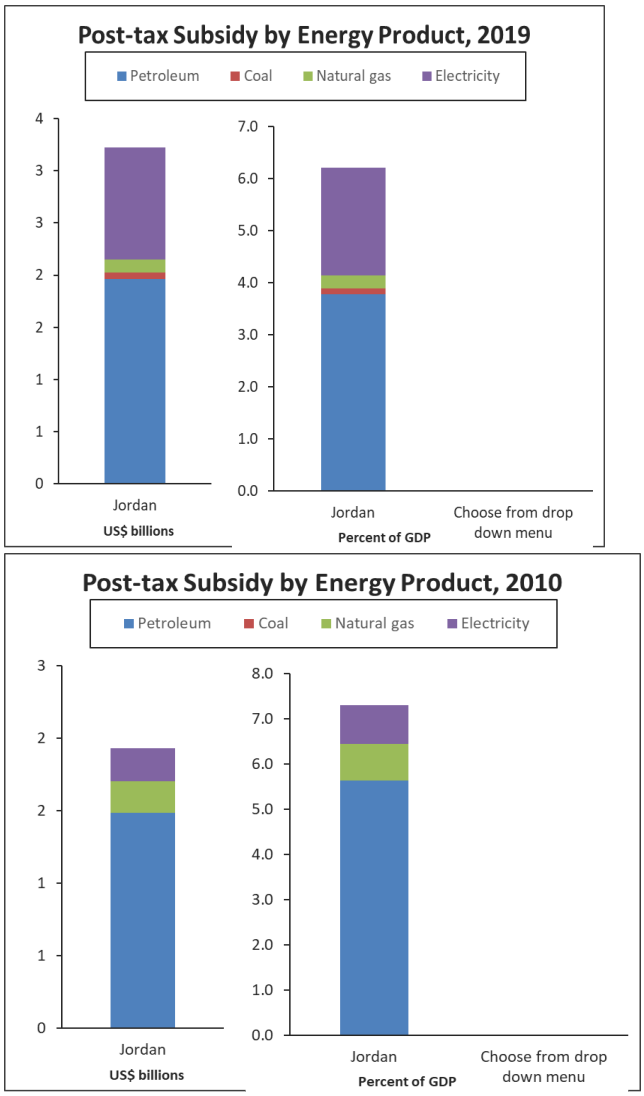
Source: IMF website, published data.

The share of cash subsidies from government expenditures in Jordan dropped from 4.8% in 2013 to 3% in 2016. Subsidies on commodities account for 0.7% of government expenditures and has not witnessed any significant decrease given its already minimal share. The share of subsidies to government institutions from total government expenditures increase from 1.12% in 2013 to 1.38% in 2016. Jordanian energy subsidies are restricted to electricity through a price reduction mechanism, and no longer cover petrol products. Food subsidies in Jordan cover wheat and its derivatives, rice, sugar, infant formula and cooking oil, as well as 24 food products exempted from taxes. As for social services, the Jordanian government subsidizes housing, potable water, higher education, and healthcare, including human medication. Subsidies on agricultural, livestock

and industrial production include subsidies on agricultural exports, fertilizers, irrigation water, animal feed, veterinary medication, industrial production materials, and local production exports. The Jordanian government also subsidizes productive public institutions. Loan subsidies are restricted to agricultural production loans.

In 2010, energy subsidies in Jordan amounted to USD 1.94 Bn at 7.3% of GDP and USD 315.75 per capita. Electricity subsidies amounted to USD 0.23 Bn at 0.86% of GDP and USD 37.1 per capita. Natural gas subsidies amounted to USD 0.23 bn at 0.81% of GDP and USD 35.2 per capita. Petrol subsidies amounted to USD 1.49 Bn at 5.63% of GDP and USD 243.45 per capita. In 2019, energy subsidies amounted to USD 3.17 Bn at 6.8% of GDP and USD 425 per capita. Electricity subsidies amounted to USD 1.08 Bn at 2.07% of GDP and USD 144.53 per capita. Natural gas subsidies amounted to USD 0.13 Bn at 0.24% of GDP and USD 17.04 per capita. Petrol subsidies amounted to USD 1.96 Bn at 3.77% of GDP and USD 263.46 per capita.

Figure 3: Post-Tax Energy Subsidies and % of GDP in Jordan in 2010-2019



Source: International Monetary Fund, Energy Subsidies Template.[9]

Tunisia

Data presented in Table 2.4[10] indicate a persistent increase in the share of government subsidies from national GDP in 2005-2012 from 3.1% in 2005 to 7% in 2012. This increase is also visible in the share of subsidies from government expenditures which grew from 15.5.% in 2005 to 25.4% in 2012. It is worth mentioning that the Tunisian government subsidizes all energy products, including electricity and petrol products.

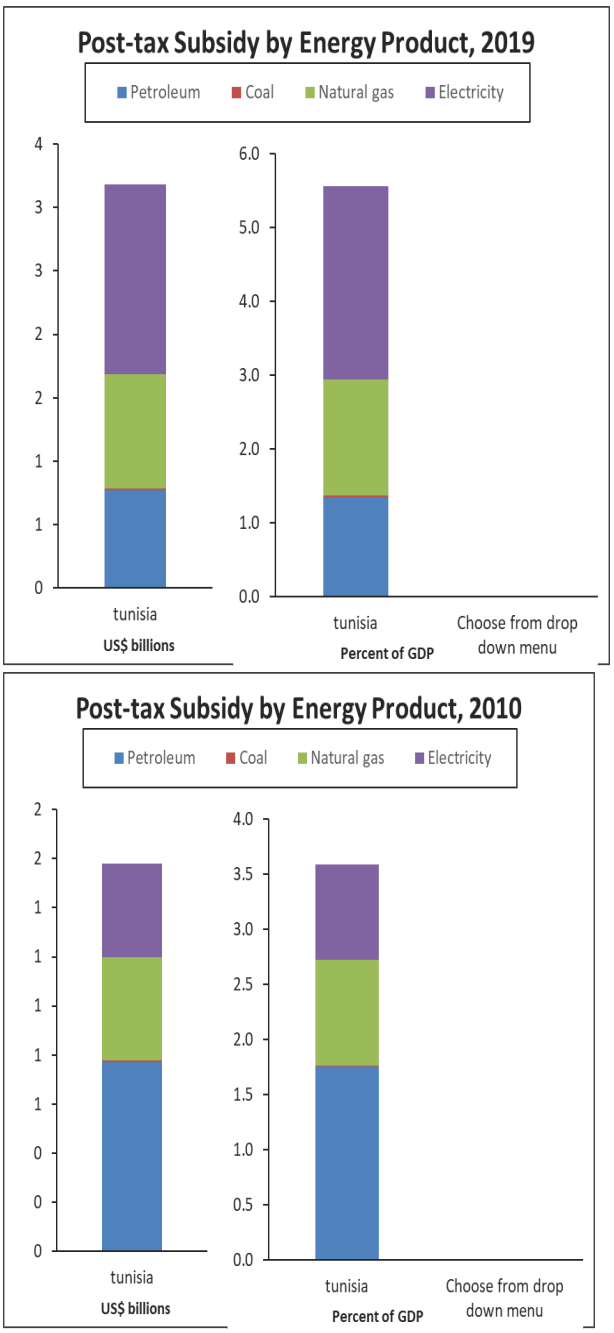
Table 4: Share of Expenditures and Subsidies from National GDP and Share of Subsidies from Government Expenditures in Tunisia

Year	% of Expenditures from GDP	% of Subsidies from GDP	% of Subsidies from Expenditures
2005	20.1	3.1	15.5
2006	19.7	3.3	16.6
2007	19.9	3.7	18.6
2008	20.9	4.9	23.5
2009	21.3	3.4	16.2
2010	21.0	3.4	16.1
2011	26.6	6.0	22.4
2012	27.5	7.0	25.4

Source: IMF website, published data.

In 2010, energy subsidies in Tunisia amounted to USD 1.57 Bn at 3.3% of GDP and USD 149.3 per capita. Electricity subsidies amounted to USD 0.38 Bn at 0.87% of GDP and USD 36.24 per capita. Natural gas subsidies amounted to USD 0.42 Bn at 0.96% of GDP and USD 39.9 per capita. Petrol subsidies amounted to USD 0.77 Bn at 1.75% of GDP and USD 73.13 per capita. In 2019, energy subsidies amounted to USD 3.17 Bn at 5.54% of GDP and USD 274.2 per capita. Electricity subsidies amounted to USD 1.5 Bn at 2.62% of GDP and USD 129.8 per capita. Natural gas subsidies amounted to USD 0.9 Bn at 1.57% of GDP and USD 77.63 per capita. Petrol subsidies amounted to USD 0.77 Bn at 1.35% of GDP and USD 66.8 per capita.

Figure 4: Post-Tax Energy Subsidies and % of GDP in Tunisia in 2010-2019



Source: International Monetary Fund, Energy Subsidies Template. [11]

Morocco

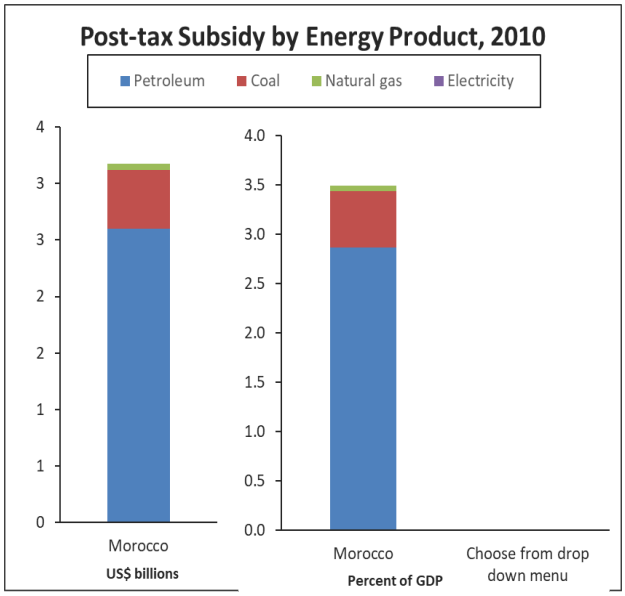
Data presented in Table 2.5 indicate a drop in the share of government subsidies from GDP in 2012-2019, decreasing from 6.5% in 2012 to 1.4% in 2019. The share of subsidies from total government expenditures also witnessed a sharp drop during the same period, from 21.7% in 2012 down to 5.5% in 2019. The Moroccan government mainly subsidizes petrol products.

Table 5: Share of Expenditures and Subsidies from National GDP and Share of Subsidies from Government Expenditures in Morocco

Year	% of	% of Subsidies from GDP	% of Subsidies from
2005	28.1	0.0	0.0
2006	25.4	0.0	0.0
2007	25.7	0.0	0.0
2008	26.9	0.0	0.0
2009	26.1	0.0	0.0
2010	27.1	0.0	0.0
2011	29.4	0.0	0.0
2012	29.8	6.5	21.7
2013	27.8	4.6	16.6
2014	27.5	3.5	12.8
2015	25.2	1.4	5.6
2016	24.6	1.4	5.7
2017	24.5	1.4	5.9
2018	24.7	1.6	6.5
2019	25.4	1.4	5.5

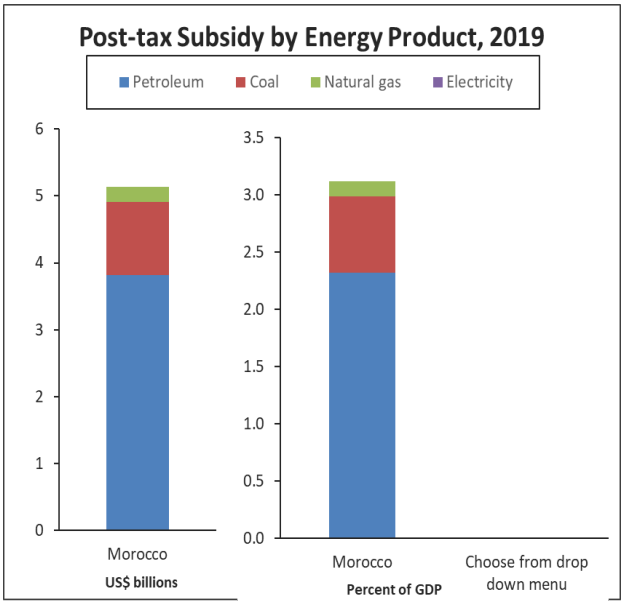
Source: IMF website, published data.

In 2010, energy subsidies in Morocco amounted to USD 3.17 Bn, at 3.5% of national GDP and USD 99.6 per capita. Coal subsidies amounted to USD 0.52 Bn at 0.57% of GDP and USD 16.3 per capita. Natural gas subsidies amounted to USD 0.05 Bn at 0.06% of GDP and USD 1.7 per capita. Petrol subsidies amounted to USD 2.6 Bn at 2.86% of GDP and USD 81.6 per capita. In 2019, energy subsidies in Morocco amounted to USD 5.14 Bn at 3.12% of GDP and USD 147.5 per capita. Coal subsidies amounted to USD 1.1 Bn at 0.67% of GDP and USD 31.47 per capita. Natural gas subsidies amounted to USD 0.22 Bn at 0.13% of GDP and USD 6.29 per capita. Petrol subsidies amounted to USD 3.82 Bn at 2.32% of GDP and USD 109.74 per capita.



Source: International Monetary Fund, Energy Subsidies Template. [12]

Figure 5: Post-Tax Energy Subsidies and % of GDP in Morocco in 2010-2019



Iraq

Data presented in Table 2.6[13] indicate that the share of government subsidies from national GDP is relatively small, and increased by half from 1.5% in 2014 to 0.7% in 2019. This drop in subsidies was the result of the low share of subsidies from government expenditures which decreased from 6.1% in 2014 down to 2.4% in 2019. The Iraqi government mainly subsidizes energy products.

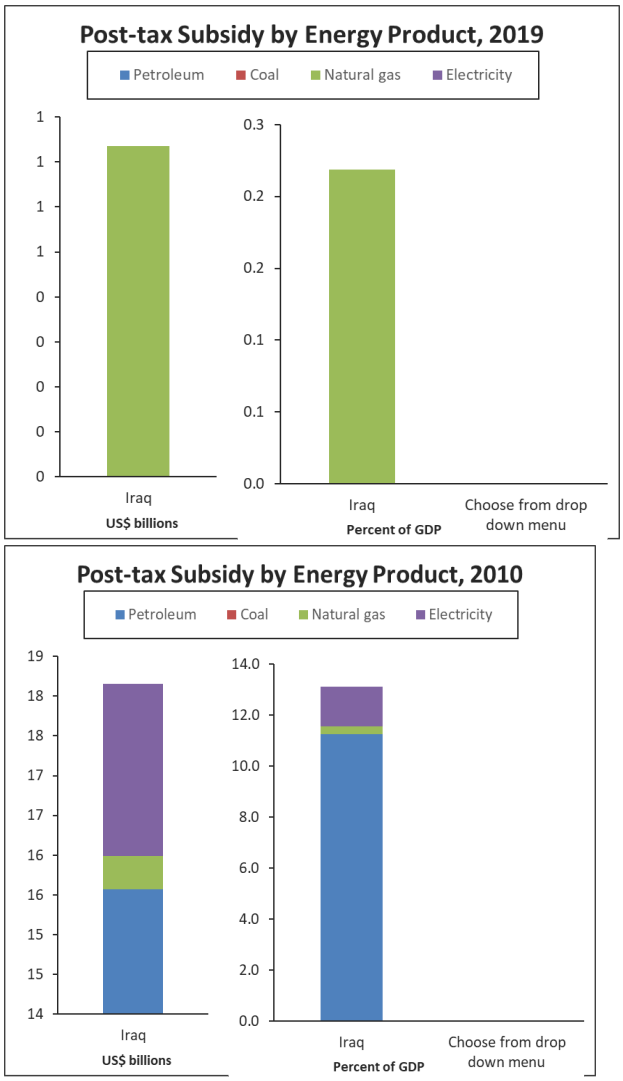
Table 6: Share of Expenditures and Subsidies from National GDP and Share of Subsidies from Government Expenditures in Iraq

Year	of % Expenditures from GDP	of % Subsidies from GDP	of Subsidies % from Expenditures
2014	25.0	1.5	6.1
2015	25.4	0.5	2.1
2016	25.3	1.3	5.3
2017	24.9	0.8	3.2
2018	24.7	0.7	2.7
2019	28.0	0.7	2.4

Source: IMF website, published data.

In 2010, energy subsidies in Iraq amounted to USD 18.15 Bn, at 13.1% of GDP and USD 573.24 per capita. Electricity subsidies amounted to USD 2.16 Bn at 1.56% of GDP and USD 68.32 per capita. Natural gas subsidies amounted to USD 0.42 Bn at 0.3% of GDP and USD 13.25 per capita. Petrol subsidies amounted to USD 15.57 Bn at 11.24% of GDP and USD 491.67 per capita. In 2019, energy subsidies in Iraq amounted to USD 0.74 Bn at 0.22% of GDP and USD 17.73 per capita, covering natural gas only.

Figure 6: Post-Tax Energy Subsidies and % of GDP in Iraq in 2010-2019



Source: International Monetary Fund, Energy Subsidies Template. [14]

Palestine

Data presented in Table 2.7 indicate that the share of government subsidies from national GDP is almost non-existent in most years in 2005-2018, and is therefore non-existent in government expenditures, except for 2006 when the share of subsidies reached 1.7% of GDP and 16.3% of government expenditures, as well as 2008 when subsidies accounted for 1.3% of expenditures. Energy subsidies in Palestine are restricted to electricity and exclude all petrol products. As for social services, the Palestinian government only subsidizes transport and provides tax reductions on plant and industrial production materials, and agricultural and industrial exports.

Table 7: Share of Expenditures and Subsidies from National GDP and Share of Subsidies from Government Expenditures in Palestine

Year	of % Expenditures from GDP	of % Subsidies from GDP	of % Subsidies from Expenditures
2005	8.6	0.1	0.7
2006	10.5	1.7	16.3
2007	9.9	0.0	0.0
2008	12.7	0.2	1.3
2009	10.5	0.0	0.0
2010	9.2	0.0	0.0
2011	8.4	0.0	0.0
2012	7.2	0.0	0.3
2013	7.6	0.0	0.0
2014	8.2	0.0	0.2
2015	7.7	0.0	0.3
2016	7.7	0.0	0.5
2017	8.3	0.1	0.7
2018	7.8	0.0	0.3

Source: IMF website, published data.

Repercussions and Future Reforms

Excessive government subsidies in many Arab States led to an increase in financial burden on government budgets, as well as increase in revenue losses due to tax exemptions granted to certain sectors, especially the energy sector. Tax losses on energy consumption in 18 Arab States amounted to USD 27 Bn in 2015, and to USD 33 Bn in 2013. Average energy tax losses in oil-producing countries amounts to USD 2.5 Bn and to USD 0.5 Bn in non-oil producing countries. Large energy subsidies, compared to lower food subsidies, compromised development subsidies and reduced the share of capital expenditures from subsidies compared to government resources, especially in non-oil producing countries where energy subsidies are higher than subsidies on healthcare, education and other basic services.

Many Arab States are trying to rectify their financial situation through reform policies focused mainly on government subsidy aspects. In spite of progress made in this regards, additional measures need to be taken, especially with regards to energy products and electricity. Arab States subsidizing electricity need to consider cost recovery, which would contribute to reducing the heavy burden on government budgets. States offering excessive food subsidies also need to rationalize the latter by setting relevant standards and caps. Arab States also need to revisit subsidies on potable and irrigation water while maintaining access for segments which are unable to afford market prices. Subsidies to productive sector also need to be reconsidered in terms of the extent of benefits granted, and tax exemptions need to be reduced in a way that does not negatively affect local investments.

Arab States present the highest levels of subsidies in the world, especially energy subsidies, at 5-6% of GDP compared to 1.5% in emerging countries. Subsidies witnessed an increase after 2000 due to the significant increase in the prices of subsidized goods (e.g. fuel and imported food products).

Relevant data indicates a general decrease in subsidies as a share of government expenditures in 2010-2019 in target countries, with the exception of Tunisia and Jordan. Surprisingly, subsidies witnessed an increase in the few years following the "Arab Spring", to sharply drop afterwards in most target countries. The largest share of subsidies is allocated to the energy sector, with energy subsidies in Arab States accounting for a quarter of global energy subsidies in 2015, after accounting for half of global energy subsidies in 2011. Data also shows that food subsidies are included in most Arab State budgets but at relatively minimal cost, accounting for less than 1% of GDP.

Many Arab States adopted subsidy reform policies in the mid-90s with the aim of gradually reducing subsidies on selected sectors, partially due to causes and factors related to the high cost of subsidies, the severe strain on government budgets, and the intent of these States to implement structural reforms to their economic, namely financial, systems. Other influential factors are rather objective and are linked to IMF directives to lift subsidies and implement financial ecosystem reforms in target States.

A Review of IMF Directives on Subsidy Reduction

The IMF continues to focus on subsidy reforms in Arab States by applying continuous pressure on Arab governments to lift subsidies, especially energy subsidies which account for the largest share of government subsidies. However, the IMF failed to consider potential social, political and economic instability that would result from the implementation of these recommendations. Subsidy elimination may not be the optimal and only solution to the significant budgetary challenges facing most Arab States. In this regard, the IMF recommends gradually phasing out subsidies. Given that subsidy elimination or reduction would affect the purchase power of low-income households and individuals, the IMF recommended lifting subsidies while establishing or expanding Social Safety Nets targeting vulnerable and low-income segments. Theoretically speaking, the IMF's suggestion seems like a solution to low-income segments, but nonetheless clashes with the fact that social protection systems are either ineffective or non-existent in most Arab States. IMF recommendations on the topic should therefore focus on response policies to the negative socioeconomic repercussions of lifting government subsidies on goods and services. Without solid social protection plans, subsidy elimination could lead to a drop in actual wages through the decrease in citizen purchase power and participation in local markets, with the living conditions of vulnerable groups at stake. Instead of calling for a gradual elimination of energy subsidies on the short term, the IMF should adapt its recommendations to the particularities of each country, taking into account the need for effective and actionable social protection plans.

The IMF should put more focus on tailoring financial policy recommendations that enable the establishment and expansion of effective social protection programs by enhancing its direct engagement with governments, NGOs and CSOs to create society-wide consensus on economic reform agendas. Promoting regional NGO and CSO engagement is particularly critical for the development of social protection plans, given the involvement of these organizations at the community level and their awareness of local conditions. NGOs and CSOs can therefore make a crucial contribution to transparent social development aiming at developing welfare programs effectively targeting vulnerable groups.

Examples of IMF Recommendations (Selected Countries)

The IMF's advice to Arab States can be summarized into subsidy elimination or reduction, with a focus on social protection systems for poor and low-income segments. A close examination of IMF recommendations to certain Arab States reveals that these States have attempted to implement said recommendations without studying their potential socioeconomic impact, which led to turmoil in these countries without enabling them to rectify their financial situation. Below are a few examples on what happened in selected Arab States:

Jordan

IMF experts recommended the implementation of spending controls and financial austerity measures, including subsidy reforms, to reduce financial deficit and national debt. Jordan started gradually lifting subsidies in 2005. In 2008, the Jordanian government lifted fuel subsidies, with the exception of gas, and implemented a price amendment mechanism on petrol products in the local market by linking them to global petrol price fluctuations, leading to a 47.5% increase in Jordanian fuel prices. The Jordanian government then adopted compensatory measures, i.e. increasing spending on vulnerable groups, increasing public sector wages, and increasing cash assistance, National Aid Fund (NAF) assistance, and assistance to farmers. These measures cost the government 3.5% of national GDP, and remained in force until 2010 when the IMF urged the Jordanian government to rationalize spending to exert more financial control, to gradually lift gas and wheat subsidies, and to review electricity tariffs. In parallel, the Jordanian government enhanced NAF effectiveness by developing eligibility requirements and enhancing targeting mechanisms.

In 2011, and in response to public pressure exercised around the same time as Arab uprisings, the Jordanian government increased subsidies on energy products from JOD 67 Mn to JOD 567 Mn. Mid-2012, the IMF approved USD 2 Bn in loans to the Jordanian government to support the latter's financial reform agenda in line with the country's economic and social conditions. In an attempt to reduce financial deficit and secure the IMF loan, the Jordanian government lifted subsidies on gas, diesel and kerosene, leading to an increase in gas prices by more than 50%, and in diesel and kerosene prices by 33%.

Egypt

Egypt has implemented the Economic Reform and Structural Adjustment Program (ERSAP) in collaboration with the IMF since the early 90s. The program aims to achieve economic stability by reducing local and foreign financial deficit and government expenditures (public sector wages, government services and assistance) and growing State revenues through indirect taxes. During that period, no reforms were implemented due to internal and external shocks to Egyptian economy, to be reinstated in 2004 with a focus on trade liberalization and subsidy reform. Nonetheless, due to the global financial crisis of 2008, ERSAP was not fully activated. In 2008, the IMF recommended lifting subsidies on food products, fuel and healthcare, and called for reviewing the subsidy system, gradually replacing in-kind food subsidies with a cash transfer system. The IMF also acknowledged that implementing a subsidy system transformation to fully cover vulnerable groups would be more time-consuming, but still recommended shifting to a cash transfer system on the short run. Since 2011, the IMF offered many recommendations to successive Egyptian governments on debt reduction through food and fuel subsidy elimination, and the implementation of financial austerity measures. The implementation of said recommendations, however, failed due to popular protests and political turmoil.

Morocco

IMF reports have reiterated that subsidies on basic commodities (especially food and fuel subsidies) in Morocco are one of the biggest obstacles impeding the implementation of proper financial controls and compromising government expenditures on investment, education and development services. In this context, the IMF urged Moroccan authorities to start implementing subsidy reforms by phasing out food and fuel subsidies. In 2009, the Moroccan government reduced the quantity of subsidized wheat as part of a pilot program aiming to replace a share of wheat subsidies with cash assistance to vulnerable groups. This program showed the government's intention to replace the comprehensive subsidy system with a comprehensive social protection plan targeting vulnerable citizens. The Moroccan government attempted to implement these reforms on the medium term in spite of related challenges, and set a cap on subsidies at 2% of GDP.

In 2011, the Moroccan government continued to subsidize fuel, including gas, as well as certain food products. However, the IMF advised the government to implement reforms mainly on energy product subsidies, given that food subsidies are less costly and achieve subsidy objectives by targeting vulnerable groups directly. In 2012, Morocco's budget deficit increased, reaching 7.6% of GDP, partially due to the increase in subsidy cost that reached USD 6.3 Bn, i.e. ~6.4% of GDP. As a result, the Moroccan government had to apply for an IMF loan to cover this deficit. The IMF, from its part, approved a USD 6.2 Bn 2-year loan to Morocco, provided that the Moroccan government reduces subsidies that amounted to USD 6.3 Bn in 2012.

Tunisia

According to IMF data, food subsidies in Tunisia were estimated at 7.3% of GDP in 2008. However, due to limited petrol and gas reserves in Tunisia and the constant increase in food and fuel prices, the IMF believes it is crucial for the Tunisian government to review its subsidy system. As such, the IMF recommended replacing these subsidies through the development of a more targeted social protection system on the medium term, enabling the Tunisian government to achieve financial sustainability, reduce economic shocks, develop a social protection system, and increase infrastructure spending.

In 2009, the IMF highlighted the importance of reducing the Tunisian government's food and fuel subsidies in order to maintain a financial margin to respond to shock impact on overall demand. Tunisia established a relatively wide Social Safety Net, hence the IMF's expectation of a relatively smooth reform process. In line with IMF recommendations, the Tunisian government implemented radical financial policy changes through public investment projects and spending control, including on subsidies. The Tunisian government also modified petrol product prices in the local market.

In 2011, the IMF persisted in recommending subsidy reforms to the Tunisian government, and called for a gradual reduction of food and energy subsidies while expanding Social Safety Nets to protect the poor. In 2013, the Tunisian government increased energy and electricity prices by 7%, the second step of its

kind within a period of 6 months. This measure was coupled with an increase in cash transfers to low-income households. These new policies did not reduce the burden on State budget, which pushed the Tunisian government to apply for an IMF loan to support its economic development agenda. The IMF's Executive Board approved a USD 1.75 Bn loan, provided that the Tunisian government implements financial reforms, especially with regards to government subsidies.

Future Vision

The above examples as well as a review of IMF recommendations to several Arab States on subsidy reforms offer a clear view of recommendations offered to these States and the changes resulting from their implementation. As such, the IMF believes that successful reforms start with proper development of a subsidy reform strategy and regular strategy implementation follow-ups given the lengthy and challenging process of implementing said strategies and achieving success. In order to enhance subsidy reform efforts, the IMF urges States wishing to succeed in this area to take the following measures:

- Governments seeking subsidy reform must raise citizen awareness on the risks of continued subsidies and the resulting budget deficit, and on the long-term benefits of subsidy reform. This step would reinforce citizen trust in their government and therefore ensure the containment of public anger in case of subsidy reduction or elimination.
- The IMF recommends establishing a social protection system before the implementation of subsidy reforms, mitigating potential impact of these reforms, especially on vulnerable segments i.e. poor and low-income households and individuals, while taking into account gradual implementation of said reforms. The IMF also recommends replacing subsidies with cash transfers or coupons to compensate the most affected segments for price increases. Governments which already launched reform efforts need to build on progress made in this regard by resuming the expansion of Social Safety Nets to provide better protection to vulnerable groups through the execution of statistical surveys aiming at identifying poor households and their consumption, enhancing social protection system transparency.
- Governments must set a clear timeline for the gradual increase of local market prices to international rates to mitigate the impact of a sudden price increase on consumers. Governments should also delay food subsidy reforms given social sensitivity to the matter, especially among poor populations, and rather lift fuel subsidies given their limited impact on vulnerable groups.
- Governments must focus on energy subsidy reforms, especially in countries which did not launch said subsidies in a way that ensures cost recovery, more specifically electricity subsidies, in order to compensate for losses incurred by State-owned electricity companies. Electricity tariff increases should also be coupled with sector restructuring to ensure improved access.
- Eliminate obstacles facing national economic sectors, especially industrial and employment-intensive sectors, which would contribute to economic growth, reduce the high unemployment rate in the Arab region, and therefore promote social welfare and reduce poverty.

Subsidies in most Arab States have hit a minimum in most sectors, and are either limited or marginal with no tangible impact. Target States also have different subsidy systems and related reforms. A rather prudent approach is noticeable in countries like Egypt, Iraq, Jordan and Bahrain, while subsidies on food commodities were implemented early on in Jordan, Lebanon and North African countries.

Subsidies on healthcare, medication prices and education prices are the most common and impactful subsidies in Arab societies. It seems unlikely that Arab governments have written and approved strategies on subsidy policy and objectives. Theoretically speaking, however, it appears that the most sought objectives through subsidy policies include protecting and providing basic commodities at reduced prices to poor and low-income households, and minimizing income inequality.

In the context of subsidy reforms adopted by most Arab States, measures taken in this regard mainly consisted in imposing indirect taxes in target sectors, floating energy product prices, either partially or fully, reducing overall subsidy value and redirecting subsidies to specific segments. Factors influencing Arab governments into implementing subsidy reforms can be divided into objective and subjective drivers. Responding to the directives of international donors and creditors was the biggest driver for subsidy reforms (objective), followed by the deteriorated economic and financial situation, and the ineffectiveness of maintaining conventional subsidy policies (subjective).

Socioeconomic Impact of Subsidy Reduction

Previous chapters indirectly tackled the objectives that States seek to achieve through government subsidy policies on goods and services. Such policies are mainly restricted to assisting vulnerable groups (poor and low-income households and individuals) by increasing their purchase power and securing their access to energy products despite price increases. The lack of energy subsidies is particularly reflected in the price increase of other goods, given that electricity and fuel prices are considered as key industrial production inputs, thus compromising the purchase power of said groups. However, the main issue with energy subsidies is that vulnerable households who need them the most benefit less than higher-income households and individuals as they don't own as many electric equipment and transportation means as wealthier groups. Energy subsidies therefore fail to achieve the main objective. On a different note, these States also provide subsidies with the aim of promoting national production, protecting their economies from heavy reliance on imported products and enhancing their export capacity. Food subsidies, on the other hand, aim at protecting the poor and ensuring their access to fundamental rights to nutrition at reasonable prices that are proportional to their income level.

Impact of Continued Government Subsidies

Despite the importance and positive impact brought by the subsidy system, the past years have demonstrated the negative repercussions resulting from excessive subsidies which outweigh its advantages. Indeed, government subsidies on goods and services led to wasteful consumption and accelerated the increase of government expenditures at the expense of revenues. This led to an increase in State budget deficit, as well as smuggling and to the emergence of parallel markets (black markets) due to price distortions. Subsidies also led to compromised public investment in healthcare, education and infrastructure, hindering economic development.

Energy subsidies encourage investments in machine-dependent sectors rather than labor-intensive sectors, which leads to the continuous increase in unemployment rates due to layoffs. Subsidizing products without covering production costs or service provision increases the burden on State treasury, and therefore increases debt. In such cases, States are compelled to resort to bank of IMF loans. This also restricts investments in renewable energy and promotes investments in sectors that are harmful to the environment.

Conventional subsidization methods and approaches also have the following repercussions:

- A decline in the share of healthcare, education and infrastructure spending from overall public expenditures in favor of subsidies that failed to achieve their key objective, and a subsequent drop in socioeconomic development indicators.
- Increase burden on State treasury, leading to an increase in public debt and domestic or external debt.
- An increase in the social gap, i.e. undercalculated subsidies, especially energy subsidies, lead to an increase in the consumption of high-income groups enjoying luxurious lifestyles vs. limited consumption by vulnerable groups.
- Increasing government subsidies pushes governments to seek compensation through tax increase, taxes being the main source of state revenues, further increasing costs borne by citizens due to increased prices and taxes.

Impact entailed by the subsidy system as per conventional subsidy policies (without reduction)

Subsidy policies adopted by Arab governments have different repercussions on many areas, and can be summarized as follows:

- Financial Impact: Subsidy policies have clearly strained budgets of Arab States. The continued "random" subsidy policy led to a considerable waste in State financial resources, increasing financial deficit and compelling governments to resort to internal and external debt to cover said deficit.
- Economic Impact: In the short term, actual benefits can be enjoyed by a number of target groups, especially in terms of access to goods and services at prices lower than the black market (welfare). However, in the long term, this welfare does not be sustained or may not empower beneficiaries. Moreover, the strain on budgets limited funding opportunities for development and productive projects that empower said groups and enable them to afford goods and services without the need for subsidies. The financial impact of subsidies, in turn, puts pressure on governments to impose more taxes to compensate budget deficits, compromising the competitiveness of local productive sectors compared to imported goods.
- Social Impact: Untargeted subsidy policies contributed to the emergence of a social class that takes advantage of the system's errors and loopholes in subsidy programs to enhance their illicit benefits from the subsidy system. Subsidy policies have also reduced the efficiency and output of education and health systems. Moreover, the subsidy system produced unsupportive values (e.g. extravagance and waste in consuming subsidized goods and services, misuse of subsidies by hoarding subsidized goods and reselling them at market prices, in addition to the circulation of commodities in black markets without official control or fair pricing).

Impact of Government Subsidy Elimination

- Excessive government subsidies in Arab States, especially subsidies on energy products which account for the largest share of the government subsidies, led to an increase in State budget deficits in said States. Arab States were therefore compelled to seek loans from the IMF to cover said deficit and to adopt economic reform policies. The IMF required these countries to lift government subsidies on goods and products, especially energy subsidies, as a first step towards economic reform policies. These policies are expected to achieve the following impact:
- Reduced consumption of subsidized products and goods, especially energy products, due to price increases after subsidy elimination, reducing demand on said goods. A World Bank study showed that the full elimination of subsidies on petrol products in Jordan would reduce consumption by 2.9% per household. As for households with the lowest income, the drop would be higher and estimated at 3.8%. Low-income households would only be affected by large increase in natural gas and basic foodstuff prices, while the impact is less prominent with increased gasoline and diesel prices. As for electricity, subsidy elimination would reduce consumption by 3.6% per household vs. 5.7% for low-income households.
- Increased poverty rate in case these countries do not establish or enhance social protection systems. The full elimination of subsidies would increase the poverty rate by 1.6 pp, especially with the increase of gas prices, as it presents consumption rates among poor households. The elimination of energy subsidies would increase poverty rate by 2.4 pp.
- Lifting government subsidies would increase State revenues. The World Bank estimated that lifting subsidies on petrol products in Jordan, for example, would generate an increase in government revenues by JOD 389 Mn per year, and government savings amounting to JOD 473 Mn from electricity subsidy elimination.
- Increased government spending on development projects, especially in healthcare and education sectors, and on infrastructure projects, promoting economic development.

Subsidy System Impact in Light of Reforms and Subsidy Reduction

Recent measures taken towards the implementation of subsidy system reforms through subsidy reduction or elimination achieved the following impact:

Financial Impact: Reduced government expenditures and slightly improved target State budgets, as the reduction achieved in financial deficit was lower than the reduction in subsidies. The financial situation in these States seems to suffer from structural imbalances, and subsidies are unlikely to be the main and only cause.
Economic Impact: Unemployment and poverty rates in Arab States are always on the rise. The reduction of food subsidies for example contributed to the decrease in consumer purchase power, not to mention reductions in electricity and fuel subsidies. Employers are increasingly pressured to raise employee salaries. On the other hand, energy and fuel subsidy reductions led to an increase in production costs incurred by local producers, which was reflected in compromised competitiveness of local products vs. imported goods and products. On a different note, subsidy reductions can lead to fiscal surpluses that can be reallocated to development plans and projects.
Social Impact: As a result, the circle of poverty expanded to include new households and groups due to the reduction of subsidized goods and services. The reforms adopted in financial systems were not coupled with precautionary measures to protect marginalized and low-income populations. The quality of healthcare and education services showed no improvement in target countries, which adversely affected quantitative and qualitative healthcare and education indicators in many of these countries.

Proceeding with the reduction policies (subsidy elimination) on basic goods and services without adopting any alternative plans could increase the inequitable revenue and wealth distribution and contribute to the emergence of populations and groups with no (or reduced) middle class. This would result in anger and resentment among many Arab societies, leading to protests and movements against government policies in these countries.

Recommendations

Experts seem to agree that subsidy reforms in Arab States were not feasible, and rather had an adverse social and economic impact in some cases. Measures adopted contributed to an increase in the income gap and a decrease in the purchase power of affected segments without any adequate alternatives. These measures also led to the expansion of the poverty circle to include new groups that previously relied on subsidies. These groups were not compensated through sufficient and adequate support mechanisms.

Reform strategies and subsidy reductions were met with several responses and reactions. Many agreed that basic services such as healthcare and education were negatively affected, and that the social fabric in Arab societies was damaged.

The reduction of Arab State energy subsidies was a key focus area for the IMF given their relatively high weight and cost. However, many agree that the reform instructions provided by the IMF were not coupled with precautionary measures to protect affected households and groups, and did not take into account the social and economic context of target countries.

It would be fair to say that the dilemma does not lie in the reform instructions per se, but many observations and major problematic points can be detected in the mechanisms adopted to implement the desired reforms. Two underlying questions can be raised, the answer to which would be a guideline to formulate proposals that would help reach an appropriate formula that ensures the balance between the intention of countries to reduce the economic strain caused by the conventional approach to subsidies on goods and services on one hand, and that protects the right of vulnerable and low-income individuals and household to meet their basic needs at reasonable and fair prices on the other.

First: What are the measures that could have been avoided?

- Comprehensive reduction of all types of subsidies
- Reduction timing in terms of social and economic conditions
- Lack of parallel social protection packages targeting marginalized groups and households
- Lack of additional measures to ensure budget improvement in target States
- Lack of examination of the efficiency and impact of reforms in terms of achieving set economic objectives (fight against poverty, unemployment and inequitable revenue distribution, promotion of productive sectors, and increase of GDP per capita…)

Second: What is the most efficient strategy to achieve long-term reforms?

- Governments seeking subsidy reform must raise citizen awareness on the risks of continued subsidies and the resulting budget deficit, and on the long-term benefits of subsidy reform. This step would reinforce citizen trust in their government and therefore ensure the containment of public anger in case of subsidy reduction or elimination.
- Governments must implement a progressive and selective subsidy reduction according to a predetermined timeline that sets the subsidy elimination rate for

each period, which would contain public outrage on price increases. This would also help citizens gradually adapt to price increases rather than being shocked by a sudden increase.

- Governments must exclude certain productive sectors from (e.g. agriculture and industrial sectors) from adopted subsidy reduction and reform programs and take into account the local economic and social conditions and context.
- Governments must substitute subsidies on goods and services with cash transfers to vulnerable households, provided that target groups are carefully identified through periodic social surveys in this regard.
- Governments must increase focus on marginalized groups affected by reforms by compensating them with direct subsidy packages (cash – coupons) and indirect subsidy packages (provision of adequate health and education services for free or at affordable prices). Establish social protection systems before taking any step towards subsidy elimination, ensuring that subsidies are lifted without vulnerable groups paying the price and ensuring that their purchase power is not heavily affected.
- Governments must promote investments in renewable energy, which would have many positive effects, particularly the increase of employment in investment companies. This would decrease unemployment rates, reduce pollution and alleviate the financial burden on government budgets.
- Governments must redirect subsidy funds towards investment projects that aim at employing the largest number of employees, decreasing employment and poverty rates, and reallocate a share of project returns to infrastructure and social development, namely healthcare and education.

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8 According to the statements made by the Lebanese Prime Minister to CNN, 74 percent of more than $10 billion dollars spent on subsidies in September were misused by traders, and were therefore not targeted towards their actual beneficiaries. https://www.france24.com/en/live-news/20210922-lebanon-raises-fuel-prices-as-subsidies-are-phased-out

9 https://www.imf.org/~/media/Files/Topics/Environment/energy-subsidies/fuel-subsidies-template.ashx

10 No available data on government subsidies in Tunisia after 2012.

11 https://www.imf.org/~/media/Files/Topics/Environment/energy-subsidies/fuel-subsidies-template.ashx

12 https://www.imf.org/~/media/Files/Topics/Environment/energy-subsidies/fuel-subsidies-template.ashx

13 No available data on government subsidies in Iraq before 2014.

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