Managing the Impacts of Fuel Subsidy Reform: Lessons from Indonesia Experience

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A framework for thinking about fuel subsidy reform

**What type of reform?**
- Which fuels/users?
- Type of reform
- Scale of reform
- Staging and timing of reform

**What to do with the fiscal savings?**
- Fixed price
- Index
- Price
- Volume
- Structural policy

**What are impacts on welfare and the economy?**
- Poverty and distributional impact
- Macroeconomic effects
- Fiscal balance
- Sensitivity analysis

**How to communicate the reforms?**
- Identify key stakeholders
- Coordinate plan across govt
- Transparency
- Public Information campaign

**Compensation program**
1. Who receives it?
2. How much?
3. How long?
4. How to deliver it?
Temporary compensation to households will help smooth the reform process

1) Mitigating the impact of higher prices, especially for poor and vulnerable households
   • Removing fuel subsidies hurts all households by contributing to rising inflation, with the bottom 40 percent feeling the impact the most

2) Contributing towards broad-based support for fuel subsidy reforms
   • Can build support within groups who are likely to oppose fuel subsidy reforms

3) Using the opportunity to strengthen a comprehensive social protection system
   • Introduce innovations to support longer-term social protection reforms efforts
The design of a compensation program needs to be done as part of the overall fuel subsidy reform design.

**REFORM DECISIONS: SCALE, TIMING, SAVINGS**

**COMPENSATION OBJECTIVES**
- WHO TO COMPENSATE?
- HOW MUCH TO COMPENSATE?
- HOW LONG TO COMPENSATE?

**COMPENSATION DELIVERY METHOD**
Decisions about price-setting, timing of reform, anticipated impact will influence the design of the compensation program.

**REFORMS?**

**What are the main reform decisions?**

- **Degree of subsidy reduction**
  - Move pricing entirely to economic price
  - Close gap to economic price, but wedge remains

- **Pricing reform decisions**
  - What is the timing of reform?
    - Phased over time
    - Big bang
  - What is the path of price increases?

**What are the impacts?**

- **Fiscal savings**
  - How much, each year

- **Inflationary impact**
  - How much, each year

- **Poverty impact**
  - How much, each year

**What are the compensation objectives?**

- **Poverty**
  - Mitigate impact on the poor and vulnerable

- **Buy-in**
  - Achieve broader buy-in

- **Fiscal**
  - Remain fiscally sustainable
Targeted approaches mitigate negative impact, while universal compensation builds support for reform.

### REFORMS?

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<th>WHO?</th>
<th>HOW MUCH?</th>
<th>HOW LONG?</th>
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### Targeted

**Advantages of Targeting**
- Mitigates negative impact on poor and vulnerable households.
- Lower cost compensation package.
- Ready to implement because a national targeting system has already been created.
- Flexible: Can be targeted at various coverage levels.

**Disadvantages of Targeting**
- Inclusion errors: some non-poor and even wealthy may receive benefits.
- Exclusion error: some poor and vulnerable may be excluded from beneficiary lists.
  - In the past, this has driven local complaints because some non-beneficiaries are similar to beneficiaries.
  - More complicated: requires sophisticated targeting and updating mechanisms

### Universal

**Advantages of Universal**
- Easier to implement (unless go to near-universal)
- Drives broad buy-in
- Does not exclude any poor
- Avoids social conflict
- More equitable than current subsidy benefit incidence

**Disadvantages of Universal**
- Fiscally more expensive way to compensate the poor and vulnerable
- May make it harder to turn compensation off in the future
Setting the benefit level, its level over time and frequency depends on the aim of the compensation program.

**REFORMS?**

**WHO?**

**HOW MUCH?**

**HOW LONG?**

**HOW?**

### How much to compensate?

**To prevent poverty increase:**
- Provide amount to keep poverty flat, or falling to desired target.
- This depends on the size of price increases, but is easily modelled.

**To build buy-in for reform:**
- Provide amount required to compensate for the subsidy lost by a particular level of consumer.
- This can be calculated from household survey data (Susenas).

### Fixed or variable benefits?

**Fixed**
- Provides budget certainty.
- Easy to explain publicly and community to beneficiaries.

**Variable**
- Benefit levels can increase over time with inflation.

### Frequency of benefits?

**High frequency**
- Smooths inflation impact over the year, but...
- Increases program administrative costs and out-of-pocket costs for beneficiaries.

**Low frequency**
- Lower administration costs and out-of-pocket costs, but...
- Households tend to spend benefits immediately, leaving them exposed to inflationary impact along the year.
The duration of compensation influences immediate impact, public perceptions, and long-term impacts.

- **Who?**
  - Ability to withstand shock
    - Provide sufficient duration to allow households to adjust their consumption behavior to new prices.
    - Allow time for household incomes to grow to compensate.
    - Allow time to reform long-term social protection programs to provide ongoing protection to the poor and vulnerable.

- **How much?**
  - Achieve buy-in for reform
    - Allow sufficient duration to achieve the level of buy-in needed for the reform.
    - But not too long, otherwise face the risk of entrenchment. The longer compensation runs, the harder it may be to turn off.

- **How long?**
  - Prevent political exploitation
    - Duration needs to be set and communicated at the beginning of the program in order to avoid the risk of later being extended for political purposes.
In selecting the mechanism to deliver compensation to beneficiaries, there are several factors to consider.

**REFORMS?**

- **WHO?**
- **HOW MUCH?**
- **HOW LONG?**

**HOW?**

**Learning from past experience**
- How has compensation been delivered in Indonesia in the past?
  - Indonesia has designed and implemented compensation programs for fuel subsidy adjustments in the past (2005, 2008 and 2013).
  - These experience provide lessons learned about what has worked and where improvements are needed.

**Program effectiveness**
- How effective are program options for delivering compensation?
  - The effectiveness of compensation programs can be determined by using criteria to assess both current and proposed programs.

**Delivery factors**
- How should programs be effectively and efficiently implemented?
  - Decisions are needed at each stage of implementation. An implementation roadmap can help improve program delivery.

**Global experience**
- How have fuel subsidy compensations been used in other countries?
  - Lessons can be learned from other countries that have undertaken, successfully or unsuccessfully, fuel subsidy reforms.
Indonesia’s first fuel subsidy reform in 2005 introduced unconditional cash transfers to compensate households.

**Fuel price**
- Household gasoline and kerosene prices increased by 150-185 percent

**Compensation**
- The Office of the Vice-President and Bappenas oversaw the implementation of an unconditional cash transfer program known as *Bantuan Langsung Tunai*, BLT.
- Rp 23,106 billion (nominal) was spent on the program.
- 19 million households received a total of Rp 1.2 million in four tranches. Almost all received the full amount, only 10 percent experienced deductions.
- Targeting accuracy compromised by quick preparation (5 months). The poorest 40 percent of households received two-thirds of total BLT benefits.
- Reallocation of saving also benefitted households through health fee waivers (Jamkesmas), education benefits (BOS and BSM), and public works (KDP).

**Impact**
- BLT more than offset, on average, the negative impact of the fuel price increase for the poor.
- Poverty increased but this was due to an increase in rice prices that was mostly due to a ban on rice imports.
The temporary cash transfer program was deployed again in 2008, with research indicating positive impacts

**Fuel price**
- Price of household gasoline increased by 33 percent, kerosene by 50 percent.

**Compensation**
- The Office of the Vice-President and Bappenas redeployed BLT.
- Rp 17,809 billion (nominal) was spent on the program.
- 19 million households received a total of Rp 900,000 in three payments over a 9 month period. Nearly 50 percent of beneficiaries experienced deductions.
- Only minor adjustments in beneficiary lists – 93 percent of households were also beneficiaries in 2005 – leading to no significant improvements in targeting.
- The poor and vulnerable also benefitted from subsidy savings reallocated to expand Jamkesmas to 76 million individuals.

**Impact**
- BLT led to positive outcomes: households experienced higher school enrollment, lower levels of child labor, and increases in utilization of health services.
- Households spent funds on essential expenses (rice, transport, school fees, Idul Fitri expenses), not on harmful items such as cigarettes and alcohol.
- BLT did not lead to laziness: beneficiary households found new jobs at higher rates than non-BLT households.
The compensation program in 2013 was better targeted and introduced reforms to provide integrated assistance.

**Fuel price**
- Price of subsidized fuel increased from IDR 4,500 to IDR 6,500

**Compensation**
- The TNP2K Secretariat oversaw the implementation of an unconditional cash transfer program, renamed Bantuan Langsung Sementara Masyarakat (BLSM).
- Rp 9,300 billion was allocated for the program.
- 15.5 million households (the bottom 25 percent) received a temporary unconditional cash transfer of IDR 600,000 and an extra Raskin allocation of 45 kg at Rp 1,600 per kg.
- In addition, scholarship (BSM) and conditional cash transfer programs (PKH) were significantly expanded and benefit levels increased.

**Impact & Innovations**
- Poverty would have increased by 2.5 percentage points without BLSM, but the actual increase was only 0.1 percentage point.
- Targeting performance improved since beneficiaries were drawn from the UDB.
- Instances of violence and negative social impacts were rare.
- Beneficiaries received an integrated card, Kartu Perlindungan Sosial (KPS), that entitled households to receive BLSM, Raskin, and BSM benefits.
The latest compensation program in 2015 under the new government

**Fuel price**
- Price of subsidized gasoline increased from IDR 6,500 to IDR 8,500, diesel from IDR 5,500 to IDR 7,500.

**Compensation**
- 15.5 million households (the bottom 25 percent) received a temporary unconditional cash transfer of IDR 400,000, renamed as Program Simpanan Keluarga Sejahtera (PSKS) and an extra Raskin allocation to 15 times of distribution in a year of 15 kg per distribution per household.
- Scholarship (BSM) and conditional cash transfer programs (PKH) were significantly expanded and benefit levels increased.
- Expansion coverage to 86.4m individuals using Kartu Indonesia Sehat.
- Village Infrastructure Development: community-based cash for work covering 2450 poor rural and 1400 poor urban villages, plus 6040 non-poor areas.

**Impact**
- Fiscal savings around IDR 195 trillion (US$ 15.6 billion or 1.6% of GDP)
- Decrease in the consumption of subsidised fuel to only 7.06 million kiloliters from January to July, compared to 7.9 in 2014, a 9% reduction.
- Decrease in the consumption of diesel to 16.02 million kiloliters by the end of the year, compared to an allocated quota of 17.05 million, around 6% lower than anticipated.
Thank you