Impact of energy subsidies on Oman’s national competitiveness

Presentation for session one

May 2016
Efforts to understand energy subsidies are complicated by the difficulties associated with defining them in the first place.

Subsidies can be defined by the type of price-driven losses incurred...

...and also by a wide range of implementation tools.

Relative price of energy sold:
- Carbon tax and other externalities
- International price
- Cost of production

Instruments used to provide subsidies:
- Energy sector regulation
- Tax concessions
- Cross subsidies
- Credit subsidies
- Passive management of negative externalities
- Direct financial transfers
- In-kind subsidies

Source: SGI; IMF; IEA; World Bank; Monitor Deloitte analysis
Depending on the definition used the value of energy subsidies in Oman is estimated to be in the range of ~1.2 to ~9.5 bln. USD

### Oman subsidies, by type and energy 2015 (Mln. USD)

<table>
<thead>
<tr>
<th>Type</th>
<th>Electricity</th>
<th>Oil Products</th>
<th>Natural Gas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic Loss¹</td>
<td>1.163</td>
<td>1.163</td>
<td></td>
</tr>
<tr>
<td>Opportunity Cost²</td>
<td>2.192</td>
<td>1.155</td>
<td>492</td>
</tr>
<tr>
<td>Sustainable Competitiveness³</td>
<td>9.452</td>
<td>4.370</td>
<td>2.460</td>
</tr>
</tbody>
</table>

### Oman Post-tax subsidies by type 2015 (% of total)

- **4%** Congestion
- **9%** Local air pollution
- **15%** Foregone consumption
- **26%** Tax revenue
- **45%** Global Warming
- **7.750** Types of subsidies

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¹ 2015 data by Oman Electricity Authority; ² 2015 Opportunity cost calculated as difference between domestic and international price multiplied by consumption; ³ 2015 IMF Estimates

Source: Oman Electricity Authority; IMF; IEA; World Bank; Monitor Deloitte analysis
Despite being lower than the GCC average, Oman has one of the highest relative levels of energy subsidies in the world.

**2015 Comparative subsidies per capita and as % of GDP**

<table>
<thead>
<tr>
<th>Region</th>
<th>USD per capita</th>
<th>Pre-tax subsidies per capita</th>
<th>Post-tax subsidies per capita</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>GCC</td>
<td>4.457</td>
<td>13%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Oman</td>
<td>3.311</td>
<td>12%</td>
<td>17%</td>
<td>17%</td>
</tr>
<tr>
<td>CIS</td>
<td>2.239</td>
<td>3%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Advanced Countries Avg.</td>
<td>1.964</td>
<td>17%</td>
<td>17%</td>
<td>17%</td>
</tr>
<tr>
<td>Emerging Asia</td>
<td>1.273</td>
<td>7%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Emerging Europe</td>
<td>782</td>
<td>20%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Middle East, NA &amp; Pakistan (excl. GCC)</td>
<td>509</td>
<td>11%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Latin America &amp; Caribbean</td>
<td>456</td>
<td>5%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Africa</td>
<td>487</td>
<td>1%</td>
<td>5%</td>
<td>5%</td>
</tr>
</tbody>
</table>

1) Total of post tax and pretax subsidies. 2) The number for pre-tax subsidies estimated by Monitor Deloitte

Source: Oman Electricity Authority; IMF; IEA; World Bank; Monitor Deloitte analysis
Though progress has been made to enhance transparency in how subsidies are distributed, there is still a lack of clarity in some areas.

Note: Energy flows relative flows are calculated based on IEA 2013 energy balance data. Flow charts are simplified to exclude all single flows below 1 000 Mote. Subsidy flows are for illustration purposes only.

Source: IMF; IEA; World Bank; Monitor Deloitte analysis
There are ways of untangling subsidies to elevate negative socio-economic implications

INITIAL RATIONALE

Avoid inflationary pressures

Consumption smoothing

Foster industrial development

Protection of the poor from high energy prices

Expand access to energy

RISKS ASSOCIATED WITH “LIFTING” SUBSIDIES

Business/industry risks
- Temporary reduction in international competitiveness owing to higher prices

Macroeconomic risks
- Short-term negative consequences to GDP
- Short-term inflation
- Short-term price volatility

Social welfare risks
- Reduced household incomes
- Unemployment as firms go out of business
- Increased poverty levels
- Reduced access to energy

MITIGATION MECHANISMS

- Phased approach to allow industry time to adapt
- Extend and improve access to credit
- Complementary monetary policy changes to deal with inflationary impacts
- Transfers: e.g. increase non-taxable income; introduce/increase minimum wage; cash transfers for vulnerable groups
- Infrastructure projects/investment in order to ensure access to electricity/fuel

Source: GSI; IEA; Monitor Deloitte analysis
In addition to hindering the efficient use of economic resources, subsidies discourage progressive economic innovation.

Effect of subsidies on strategic competitiveness factors in Oman:

- **Wasteful** consumption of main strategic natural resources
- **Hazards** negatively affecting population – strategic resource
- Potential intellectual capital is not employed in **innovation**

**Context for Strategy**

Large corporations become largely numb to risks associated with market **innovation**

**Factor conditions**

Local competition and trade is discouraged (example – beneficial power trade)

**Demand conditions**

Energy consumers are not provided with stimuli to purchase **innovative** products and services

**Related industries**

High Value-Add, innovative industries lack stimuli for **innovation**

Source: GSI; IEA; Monitor Deloitte analysis
One could argue that subsidies have already contributed to offsetting Oman`s competitive advantage

Oman Global Competitiveness index performance 2015-2016

Oman is already lagging in terms of innovation, labor market efficiency and higher education standards - subsidies being a contributing factor
Closing remarks

Oman looses yearly around ~1.1 Bln USD, fiscally and ~2.2 Bln USD in opportunity revenues even despite global fall of energy prices, that amounts to ~520 USD per capita

Additional 7.2 Bln USD is “lost” essentially on account of the “future” meaning deferred losses of the competitiveness of the economy. That represents ~1 700 USD per capita per year

Those subsidies hit where it “hurts the most” – ability innovate and efficiency of the higher education, while offsetting effect of favorable efficiency of the institutions and natural resources

Therefore, arguably there is no such thing as efficient subsidy lift without strong connection to country strategy, social and economic policy
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