

Ending Fuel Subsidies—It's Time

BY RAJ KANNAN



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Ending fuel subsidies and raising the price of fuel has been a political landmine for most governments and to its credit, the outgoing Indonesian government had the courage to increase fuel prices thrice in two terms. With the election looming, both presidential candidates promise to have fuel subsidy reform.

The crux of the subsidy issue is twofold—first it is a massive burden on the state budget. From 2010 to 2013 alone the government's total cost for funding the subsidy was a whopping Rp 699 trillion. For 2014, the budgeted amount for the subsidy was Rp 210 trillion; almost triple the 2010 budgeted amount

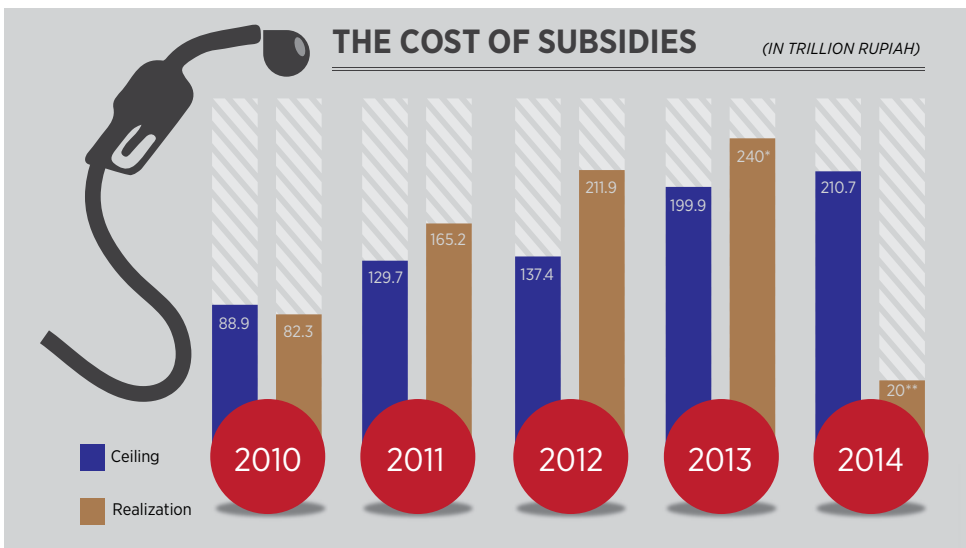
of Rp 88 trillion. The second issue with the subsidy is the variance between the budgeted and actual subsidy. For example, in 2012 the government budgeted Rp 137 trillion but sadly the actual subsidy was Rp 212 trillion, 50% higher than the budget, due to a rise in the crude oil prices. In 2013 the variance was 20% higher.

The impact of these subsidies is the erosion of the budget for other important government programs including infrastructure. In fact this burden is so large that the 2015 budget for the Public Works Ministry is being trimmed by 40%, from the requested Rp 121 trillion to just over Rp 75 trillion, which is Rp 10 trillion below the 2014 budget. These drastic cuts caused by the subsidy burden will have a direct impact on growth. While the sudden removal of the fuel subsidy would lead to strife for the incoming government, I note that both presidential

candidates are keen on subsidy reform—with a view to abolish it over time.

One option is changing the structure of the subsidy itself. Currently, the government fixes the price at the pump and the subsidy floats with the global crude oil price. The government could reverse this structure by fixing the subsidy amount and let the pump price float with the crude oil price. This step moves in the direction of phasing out the subsidy by introducing the idea the government is still providing a subsidy, but the pump price can vary depending on the crude price. Over time, once everyone can live with a variable fuel price, the fixed subsidy can be reduced and eventually removed altogether, as is true in most countries in Asia.

In addition, as discussed in earlier columns, the incoming government can consider the option of directing the budget savings from reducing the subsidy to funding strategies for better roads, such as creating an "Indonesian Road Fund." With these efforts, the country might pay higher pump prices because the actual wear and tear on vehicles is reduced by better road conditions. I believe that whomever wins will reform the subsidy program. It is time to phase out the fuel subsidy and redirect those funds into needed infrastructure and other programs to support national growth. 



Source: *Bisnis Indonesia*

* UNAUDITED

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