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**CARLOS DE LA TORRE:** My name is Carlos de la Torre, and I am a [? BCTN ?] scholar with the Malaysia Sustainable Cities Program, a joint MIT-UTM initiative. I am a former revenue advisor with the State Government of Madhya Pradesh, India and with the Ministries of Finance of Cambodia and Indonesia.

During this video, I would like to talk to you about how a complimentary bottom-up approach may improve the rate of success in energy subsidy reform in Malaysia. First, let me give you some background on energy subsidies and subsidy reform initiatives in Malaysia.

Authorities have adopted fossil fuel energy subsidies to provide temporary or permanent buffer against changes in international oil prices, support a state-owned energy companies as a component of industrial policy, and provide access to energy services to low income groups. Over time, authorities have realized that energy subsidies have several unintended consequences and costs. Energy subsidies have been associated with fiscal imbalances, displaced priority [INAUDIBLE] spending, and overspending in road infrastructure, excessive energy consumption, and under-investment in existing electric utilities and in renewable energy, degradation of local air quality. An inequity of subsidies are captured by higher income households.

In Malaysia, the cost of energy subsidies have been estimated at 6% of GDP, or \$24.2 billion in 2015. The estimate would be conservative, if it excludes, for example, tax incentives and government loan guarantees to the fossil fuel industry in Malaysia.

In order to reform energy subsidies, authorities have used executive orders alone, or executive orders followed by legislative budget approvals. This process in both a limited number of key stakeholders, such as the Ministry of Finance and high-ranking executive branch officials. The measures were developed with the belief that this approach was faster and the information at hand was reliable enough.

Unfortunately, the absence of support by key stakeholders for subsidy reform reflects a lack of confidence in the ability of governments to reallocate the resulting budgetary savings to the next best alternative for the overall benefit of the population, concerns that vulnerable groups would not be protected, and an understanding that subsidies are a mechanism to distribute

the benefits of natural resource endowments to the population in the absence of targeted social programs.

Depending on the context, authorities can develop a series of simple steps to incorporate a complimentary bottom-up approach to the prevailing top-down approach, so as to improve the likelihood of success in an energy subsidy reform.

In the first step, authorities need to identify key stakeholders and how they relate to each other. Taking the case of electricity tariff reform in Malaysia, authorities can identify as key stakeholders the state-owned oil and gas company providing gas inputs to the system, the Minister of Finance, the Prime Minister's office, the consumers of electricity services, and the environment, represented by the Ministry of the Environment, and environmental groups, or both.

In the second step, authorities need to assess the performance of the stakeholders and society as a whole. Taking the case of electricity tariff reform in Malaysia, authorities realize that energy subsidies have led to more energy consumption, lower government revenues, and potentially more local air pollution.

In step three, once key issues are identified and rules for respectful exchange and problem solving are agreed upon, key stakeholders and authorities can begin to consider alternatives. Taking the case of electricity tariff reform in Malaysia, stakeholders and authorities can consider alternatives incorporating changes in tariff levels, changes in tax incentives that will affect the cost of capital, a cash transfer program for low income families, or a combination. Each alternative will represent a different position for each stakeholder and for the society as a whole. Two or three alternatives are then selected for a final evaluation against commonly agreed criteria.

In the final step, authorities and key stakeholders select the alternative that accommodates their interest. Taking the case of electricity tariff reform in Malaysia, authorities and stakeholders select the package of tariff rate, tax incentive, and cash transfer program measures that meet their interests, and the selection criteria. Now, the selected package can incorporate into the budget process as a budget proposal.

In summary, a complimentary bottom-up approach helps generate more information, capacity, and trust, to implement subsidy reforms. This approach, alongside a top-down one, should

improve the rate of success of energy subsidy reforms. In this presentation, we have used the case of electricity tariff reform in Malaysia to explain in detail the steps suggested. However, the same steps can be tailored to the different contexts faced by authorities in other countries.

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