Ecuador
Fossil Fuel Subsidy Reform —
The Aftermath of a reform attempt and the path forward
Reform and change does not happen in a vacuum, so let’s look at what prompted these reforms and its timing.

Volatile and state-led growth financed with debt

Fiscal situation worsening, deficit increasing

Increasing public debt to finance spending
Energy subsidies are a sizeable expenditure and are perverse socially and environmentally. 

Energy subsidies have taken up between 1.6 bn to 7 bn. They can surpass education and social protection spending. Most goes to the top three quintiles.
The largest subsidy is on diesel, which is the key fuel for transportation and important for energy generation.

Prices in Ecuador of one liter of:

- Soft drink: $1.08
- Milk: $0.80
- Diesel w/o subsidy: $0.61
- Water: $0.48
- Current price: $0.27

Fuente: Petroecuador, precios TIA Plataforma Gubernamental, 24 de octubre 2019
As part of the fiscal consolidation and structural reform agenda, steps were taken to reduce subsidies

INITIAL STEPS FOR SUBSIDY REMOVAL (SUCCESSFUL)

DEC 2018

Program with the IMF and agreement with other MDBs

Reform plans announced

MAR 2019

DECREES 883 & 887
12 DAYS VIOLENCE RIOTS, PROTESTS
NEGOTIATIONS WITH INDIGENOUS
ABOLISH BOTH DECREES

OCT 2019
A hybrid crisis with two different types of violence and a media war of fake news and misinformation.
Spontaneous and legitimate protest triggered by the reform but leveraging the general feeling of dissatisfaction and mistrust.

Organized, prepared and deployed networks with the purpose of creating fear and violence under diverse forms, robbery, and attacks on strategic assets such as oil fields, general prosecutor office and media.
As part of the fiscal consolidation and structural reform agenda, steps were taken to reduce subsidies.

- **DEC 2018**
  - Initial steps for subsidy removal (successful)

- **MAR 2019**
  - Program with the IMF and agreement with other MDBs
  - Reform plans announced

- **OCT 2019**
  - Decree 883 & 887
  - 12 days violence riots, protests
  - Negotiations with Indigenous
  - Abolish both decrees

- **NOV 2019**
  - Rejection of economic project law

- **Now**
  - Adapting reform to current circumstances
This type of reforms are particularly sensitive because they threaten engrained issues.

When working on this we are facing a wicked-hard or complex problem.
MAKING A CAKE IS A SIMPLE PROBLEM
BUILDING A BRIDGE IS A COMPLICATED PROBLEM
RAISING A CHILD IS A COMPLEX PROBLEM
Locating ourselves in the place and in the moment

Very challenging fiscal situation:
• ~ 60% Debt /GDP ratio
• Public spending to GDP increased to 44% of GDP from 24% in 2008
• No more commodity boom

Support of the international community to correct path
• Program with IMF and other MDBs to support adjustment and structural reforms (not covering all financing needs)

Implementation of program and policies
• Reduction of public deficit by 7 pp of GDP
• Cuts in public investment and employment
• No growth
• Increase in unemployment and incidence of poverty
<table>
<thead>
<tr>
<th>Strategic elements</th>
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<tr>
<td><strong>History</strong></td>
<td>Energy subsidy reform has historically been a delicate and traumatic process</td>
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<tr>
<td><strong>Benefits are diffused</strong></td>
<td>Benefits of the subsidies are diffuse, which makes targeting</td>
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<td><strong>Interest groups</strong></td>
<td>Subsidies are there because they are part of the current social contract, even if implicitly. Interests of different group are in balance</td>
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<td><strong>Loss aversion</strong></td>
<td>We may be asking people to leave something they receive now for a Benefit that comes in the future and it is even more diffuse.</td>
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<td><strong>Current moment</strong></td>
<td>Fiscal situation has opened space for this reform. But it is a period of adjustment, with consequences in growth, employment and poverty</td>
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<td><strong>Communication is key</strong></td>
<td>Communication is a central pillar of the reform and should start by positioning the problem and the opportunity cost</td>
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<td><strong>Coherence with other policy</strong></td>
<td>Coherence with other policies will be demanded by population</td>
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<td><strong>Long term vision</strong></td>
<td>This is a policy with longer term benefits, how can we discount them?</td>
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We knew that we needed an approach that balanced three aspects

Our action plan should then:

- Designed as an adaptive process balancing three factors
- Balance technical soundness, political feasibility and capabilities to implement
- Balance “best fit” and “best practice”
How were these factors balanced?

1. Technical soundness
   - Distributional analysis (rich benefit from subsidy disproportionately)
   - Significant part of income of the poor, will need compensation
   - Compensation designed
   - Elimination of subsidies will set right incentives, economically and environmentally
   - Impact on prices, little to none

2. Capabilities to implement
   - Systems to pay and distribute compensation in place
   - Communication campaign
   - Ability to set and charge new price at pumps
   - Control of speculative pricing by policy

3. Political feasibility
   - Authority
   - Ability
   - Acceptance

[Quote from Building State Capability]
Political space in which the reform took place

- Environmental advocacy
- Citizens
- Social Movements
- Groups affiliated to former gov
- Donors and IFIs
- Private sector
- Government
After reform is announced:

- Government
- Social Movements
- Groups affiliated to former gov
- Donors and IFIs
- Private sector
- Citizens
- Environmental advocacy

AGAINST

IN FAVOR
Now what?

The problem is on the table and the government has adapted its strategy (best practice vs best fit)

Four KEY questions for us as we navigate carbon pricing reform?

*Why does this problem matter?*
*To whom does it matter?*
*Who needs to care more?*
*How do we get them to give it more attention?*
Thanks