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Finnish Association for Nature Conservation

HARMFUL SUBSIDIES AS BARRIERS TO SUSTAINABLE DEVELOPMENT

The price of subsidy policy in Finland and the developing world

Conclusions of the report

Suomen luonnonsuojeluliitto

Harmful subsidies destroy the natural capital of Earth

Public subsidies are used to pursue economic growth and social justice. They should increase equity and safety, and steer the society towards a better, more efficient or sustainable direction. All subsidies are driven by a general interest, which makes it challenging to evaluate their possible harmful effects or carry out reform plans.

In principle, all subsidies that increase either production or consumption of natural resources are harmful to sustainable development, if their purpose or impact contradict with the principles of sustainability. These types of subsidies affect negatively on the world's natural, human or social capital, inhibit technological change, encourage population growth or exacerbate poverty (Pearce 2003)[1].

Subsidies that are harmful to sustainable development are targeted to environmentally sensitive sectors in business and industry. These include e.g. forestry, fisheries, agriculture, water and irrigation, energy production and consumption, transportation, and mining.

Subsidies are channelled to environmentally sensitive sectors through state budgets, public funds and development projects. Development banks, such as the World Bank Group and the European Investment Bank (EIB), provide funding and loans that Finland also indirectly contributes to. Economic partnership agreements that give trade a certain direction include also indirect harmful subsidies through complicated network of policies.

Billions worth of black subsidies around the globe

For example:

In Finland there are over 2 billion euros of harmful subsidies to transportation, 1.4 billion to agriculture, and around a billion to fossil fuels[2];

In the EU the transportation sector receives 150 billion euros, agriculture more than 80 billion euros, biofuels 5 to 8 billion euros, and fisheries about 3 billion euros of harmful subsidies[3];

In the world, fossil-fuel subsidies total to 400–1400 billion euros, transportation receives 400 to 700 billion euros, agriculture 300 to 500 billion euros, overuse of water more than 200 billion euros, and forestry more than 90 billion euros[4].

The presented subsidy values are mostly direct subsidies and do not include externalities. The sums are not comparable with each other directly, due to the fact that study years as well as principles vary. Some of the presented subsidy values also include externalities (such as health costs).

Why is a reform needed?

- The boundaries of our planet are being afflicted. Over-consumption of natural resources needs to stop, and global warming and loss of biodiversity brought to a halt;
- The unpredictable environmental and health impacts of harmful subsidies will cost a great deal for the society. All externalities are impossible to estimate;
- The present subsidy policies advance global inequality and injustice;
- We need great savings because of the global financial crisis. Resources should be allocated into development towards sustainable economy and low-carbon society;
- Economic activity and competitiveness can be increased by investing into green technology and eco-innovations;
- Phasing out harmful subsidies will potentially reduce unnecessary bureaucracy and improve governance;
- Political coherence, good governance, and transparency of subsidy and trade policies need to be increased. This enhances the effectiveness of development cooperation, and increases the capacity of developing nations in inducing self-supporting sustainable development; and
- Finland as well as the EU have committed to phasing out harmful subsidies.

1 Pearce, D. 2003: Environmentally harmful subsidies: barriers to sustainable development. In: OECD 2003: Environmentally Harmful Subsidies: Policy Issues and Challenges. OECD, Paris.
2 Finnish Ministry of Finance 2013, Finnish Ministry of Environment 2013
3 European Environmental Agency 2007; OECD 2013; Global Subsidies Initiative 2013, International Energy Association 2012; Sumaila ym. 2013, WWF 2011.
4 OECD, IEA, World Bank & OPEC 2010, Oil Change International 2012, International Monetary Fund 2013; World Resources Institute 2014; OECD 2011, Myers & Kent 2001.

RECOMMENDATIONS

Top of the cut list in Finland: Subsidies that enhance climate change

If Finland aims at becoming an international model of sustainable development, a restructuring of the economy is needed. By reforming subsidy policies we can advance the well-being of people and environment, decrease human and business inequality, and create a springboard for new innovations and business. In terms of competitiveness it is also worthwhile to look further into the future.

The intrinsic value of nature needs to be acknowledged. We cannot put a price tag on everything that has value to us. All strategic programs have to include a social and environmental impact assessment, and environmental organizations should be involved in program planning.

In Finland the subsidy reform should begin with handling the following sectors:

1. **Subsidy package for energy-intensive industry, a total of 685 million euros in 2014**
   - Tax deduction of the energy-intensive industry 205 million €. 80 % of the subsidy goes to electricity and 20 % to fossil fuels.
   - Lower taxation on electricity for industry and greenhouses (tax category II) 465 million €.
   - Tax deduction and lower electricity tax for the mining sector (tax category II) 15 million €.

2. **Subsidies to commuting by car**
   - Commuting expense deduction: the net impact of private car use totals to 455 million € in 2014. Subsidies to the use of public transportation should not be cut.
   - Over-compensation of kilometric allowance in work-related travel approx. 170 million €.
   - Car benefit at least 300 million €. The tax benefit from free use of company car needs to be removed.

3. **Tax subsidies for transportation, over a billion euros in 2014**
   - Lower tax rate for diesel fuel 507 million €.
   - Lower tax rate for light burning fuel used in heavy machinery 474 million €.
   - Fuel tax offset for commercial water transport approx. 40 million €.
   - Fuel tax exemption for commercial aviation over 63 million €, should be included in EU's emission trading system.

4. **Lower tax rate for peat in energy production, a total of 88 million euros in 2014.**
   - 1.Subsidies to peat industry should be removed, because its total impacts on the environment and climate are even worse than those of coal. The challenges related to competitiveness and local employment can be met by supporting e.g. clean, decentralized energy production.

5. **Energy tax refund for agriculture, a total of 50 million euros in 2014.**
   All agricultural subsidies must be based on environmental criteria, which also have to be tightened.

6. **Private sector subsidies, at least 180 million euros a year.** All subsidies that are inefficient, poorly targeted and hinder structural change towards sustainable development (up to 500 million €) need to be phased out, and the criteria for business support must be tightened. More resources should be allocated into monitoring and reporting of corporate social and environmental responsibility.

7. **1.Harmful subsidies to forestry** are not significant in economic terms (below 80 million € a year), but their impacts on biodiversity should not be overlooked. The current subsidy policy prevents forest management from becoming environmentally sustainable. Also, both social and environmental sustainability of international forestry-related development cooperation and industrial forestry subsidies needs to get more attention.

Europe needs more sustainable policies with use of energy and natural resources

Finland should be active within the EU in promoting socially and environmentally more sustainable energy and natural resource policy, and more coherent trade and development policy. Coherence is required from both the European Commission and all member states in order to fulfill e.g. the international climate and biodiversity commitments. A turn in subsidy policy can also affect the increasing economic inequality both within the EU and in the global South.

1. **Fossil fuel subsidies need to be phased out.** EU is funding through, for example, the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD), several oil and natural gas projects especially in the new member states and outside of the EU. Subsidizing ongoing coal projects should be stopped as well.

2. **Tax subsidies for fossil fuels in transportation and infrastructure that increase private car use should be removed.** Environmentally and climate friendly, connected solutions in transportation and infrastructure need to be advanced more coherently.

3. **Agricultural subsidies need to be based on environmental criteria.** That is, only actions improving sustainable agricultural operations and the quality of environment should be supported. Reforming the Common Agricultural Policy as well as international trade policies can make the agricultural sector more equal, and address the challenges of global food security.

4. **As a prerequisite for subsidies to mining and other natural resource extraction it should be guaranteed that operations are ecologically and socially sustainable as well as resource-efficient, and comply with the environmental law.** To ensure this, a thorough and independent social and environmental impact assessment needs to be carried out. Project financing of development banks has to be completely transparent, and environmental organizations should be included in the processes in order to ensure their full accountability.

5. **Subsidizing bio-fuels produced from food crops is not sustainable.** The Renewable Energy Directive of the EU should be reformed so that it is more profitable to process waste-based raw materials than e.g. palm oil.

6. **The Common Fisheries Policy has to be reformed.** The European Maritime and Fisheries Fund needs to follow the principles of sustainable development, and all decision-making must be based on scientific research. Subsidies that increase fishing capacity should be removed and funds directed to conservation, research and monitoring of the viability of fish stocks.

7. **Economic partnership agreements signed with developing countries must be consistent with EU's development policy objectives and principles of sustainable development.** Trade policy needs to be in line with the commitments stated in the Policy Coherence for Development and the Lisbon Treaty. An assessment of social, economic and environmental impacts needs to be a prerequisite for all significant partnership agreements between the EU and its southern partner states.

8. **Development cooperation projects funded by Finland and the EU should be based on a comprehensive social and environmental impact assessment.**

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Illustration: Ilja Karsikas