

REFORM OF ENVIRONMENTALLY HARMFUL SUBSIDIES and BUDGET CONSOLIDATION

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1. DEFINING SUBSIDIES

General definition:

All measures that keep prices for consumers below market level or keep prices for producers above market level or that reduce costs for consumers and producers by giving direct or indirect support.

Environmentally harmful subsidies (OECD)

“All kinds of financial support and regulations that are put in place to enhance the competitiveness of certain products, processes or regions, and that, together with the prevailing taxation jurisdiction, (unintentionally) discriminate against sound environmental practices” (OECD, 1998).

For instance,

- Support to polluting inputs
- Support to polluting products or sectors

A large array of subsidies

- Direct payments
- Low interest loans
- Price support (e.g. agriculture)
- Pricing below marginal cost (e.g. transport and energy prices)
- Support to general services (agriculture, fisheries).
- Environmentally harmful tax provisions

Environmentally harmful tax provisions

Reduced taxes :

- Diesel fuel
 - Coal
 - Aviation: tax-free kerosene, no (or reduced VAT on airline tickets)
 - Significant energy tax breaks of energy-intensive industries (e.g. Iron and Steel)
- *The EEA/OECD database on economic instruments contains about 1150 tax exemptions.*

2. Subsidies in OECD countries

EHS exist in all environmentally sensitive sectors :

- Agriculture (except Australia and New-Zealand)
- Fisheries
- Energy
- Transports
- Manufacturing
- Natural resources (water, forests...)

Agricultural support

The greatest part of total subsidies.

TSE OECD :

- 1986-88 : 299.6 B USD, 2.25 % of GDP
- 2004 : 378 B USD, 1.12 % of GDP
- 2008 : 379 B USD, 0,86 % of GDP (69 % to producers)

Since 2004, progressive decrease of TSE.

Also progressive decrease of price support.

Source: OECD

Environmental effects of agricultural support

Production support (including price support)

- Production increase
- Monoculture
- Increased use of fertilisers and pesticides

Inputs support

- Intensification of polluting inputs (fertilisers etc.)

Support based on cultivated areas and importance of cattle

- Intensive monoculture and breeding

Support to fisheries

- Mainly support to general services (R&D, management).
- Fuel subsidies (tax breaks)
- But certain form of support contribute to over-fishing: 6 B USD in 2006 (about 19% of landing value).

Energy subsidies

- Direct payments or “soft loans” for mining and power plants.
- Governments contracts with big consumers
- Tax expenditures
- Administered prices for fuels and electricity
- Aviation fuel (tax free kerosene)
- Coal : no, or reduced, taxes
- Tax breaks on diesel fuel
- Large exemptions for manufacturing sector (iron & steel etc.).
- Public investment in energy infrastructures

Estimates of fossil fuel subsidies (based on price gap methodology) in 2008

CONSUMPTION SUBSIDIES

Total: 557 B USD per year.

2.1 % of GDP

Of which :

- 312 B for oil products
- 204 B for natural gas
- 40 B for coal

Note: 37 countries representing 95 % of global fossil fuel consumption.

Source : IEA/OECD/WB 2010

Estimates of fossil fuel subsidies (based on price gap methodology) in 2008

PRODUCTION SUBSIDIES (world)

100 B USD per year

TOTAL ENERGY SUBSIDIES (world)

About 700 B USD per year

1% of world GDP

Source : IEA/OECD/WB 2010

Environmental impact

Production and consumption subsidies :

- Over production and consumption of energy.
- Lack of incentive for energy efficiency, R&D and investments
- Induces urban sprawl (transports)

Reducing or phasing out energy subsidies :

- Reduces polluting emissions
- Increases energy prices, thus reducing demand
- Increases energy efficiency.
- Reduces public expenditure.

Phasing out fossil fuel consumption subsidies by 2020 would result in :

- A reduction of 5.8 % of primary energy demand
- A 6.9 % reduction of CO2 emissions.

Source : IEA/OECD/WB 2010

Note: the G20 (2009) commitment to phase out fossil fuel subsidies

Transport Subsidies

- Uncovered external and infrastructure costs of road transport in EU (19) is estimated at 150 B € (IMPACT 2008)
- Direct subsidies to road transport in EU (25) is estimated at 16 B € (Ecologic 2006).

Water subsidies

- Water abstraction: pricing below cost of extraction
- Water supply: free supply (e.g. Ireland) or pricing below cost.
- Irrigation subsidies

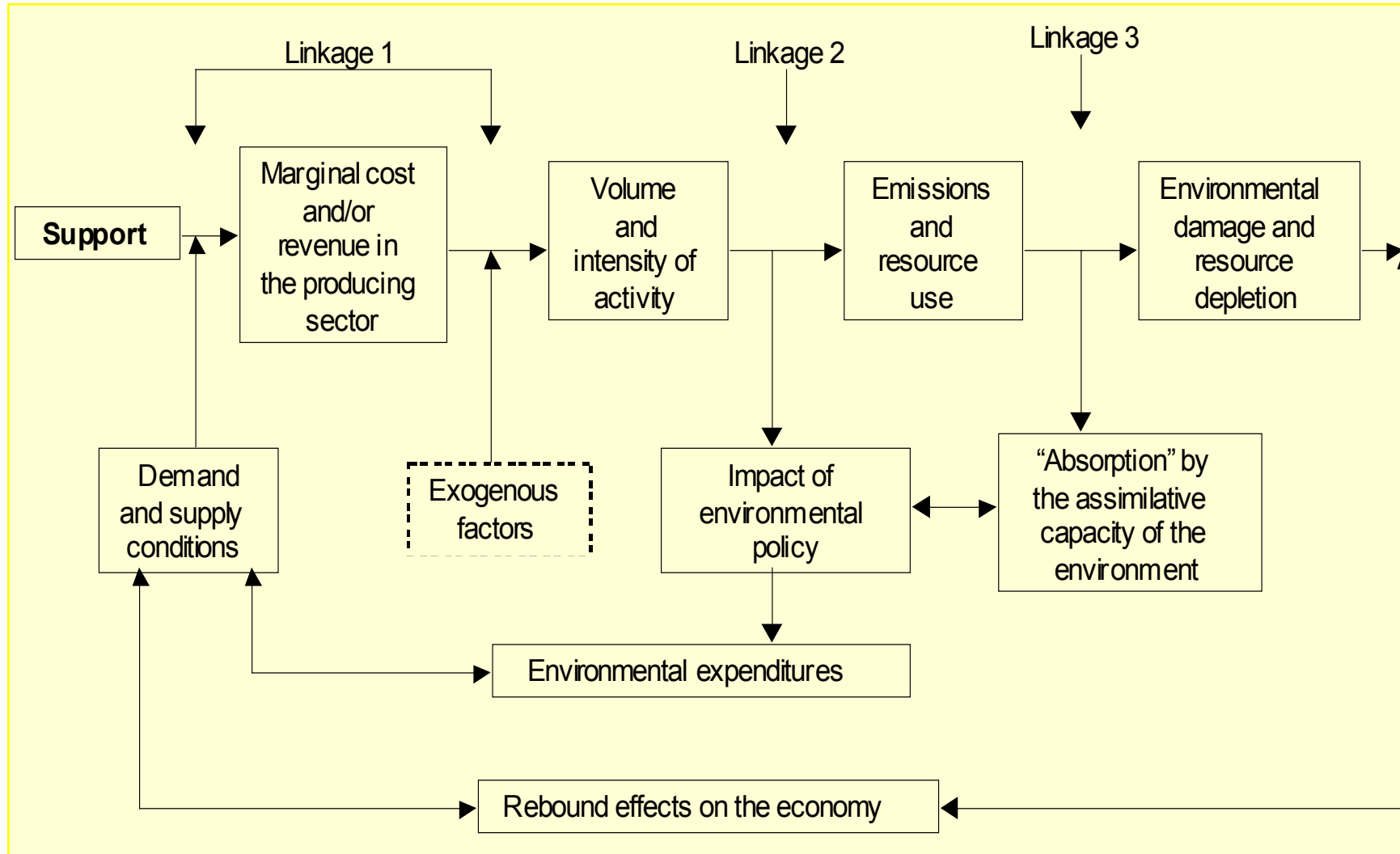
An estimated 1400 Billion USD per year in the world

SECTOR	REGION
Agriculture	OECD 379 B USD/year (2008) Biofuels: 11 B USD /year (2006, US+ EU)
Fisheries	15-35 B USD / year (UNEP 2008)
Energy	World: 700 B USD /year (IEA/OECD/WB, 2010)
Transport	World: 238-306 B USD / year, of which 173-233 B estimated as environmentally harmful (EEA 2005)
Water	World: 67 B USD, of which 50 B estimated as environmentally harmful (Myers & Kent 2002)

3. Evaluating the environmental impact of subsidies

- Complex interrelations with economic, social and environmental processes.
- The environmental impact is a function of:
 - Type of subsidy
 - Market structure
 - Competitiveness
 - Environmental problem
 - Environmental policies

The subsidy - environment and economic linkages



Subsidies also have negative economic and social effects

Increase income inequalities :

- **In developing countries.** For instance, water subsidies can benefit rich segment of the population, having easier access to urban water distribution.
- Irrigation subsidies often benefit richer farmers.

- **Between developed and developing countries:**
- Subsidies in industrialised countries create trade barriers to the detriment of DCs.
- Trades losses to DCs are estimated to 100 B USD per annum (World Bank).

Subsidies encourage resources depletion in developing countries

- **Fisheries** subsidies in rich countries (6 B USD in 2006) encourage over fishing.
- **Water** subsidies (in particular irrigation subsidies and under pricing) can cause water wastage and salinisation of soils.
- **Energy** subsidies encourage wastage.

4. Phasing out subsidies: a challenge

1. A technical challenge

- Collect and analyse data: government and private sector transparency is not granted...
- Define and analyse each type of subsidy.
- Identify and analyse environmental impacts.

2. An economic challenge:

- « Technological lock-in » effect of subsidies: e.g. subsidies tend to “freeze” the subsidised technology.
- Perverse effects on national and international competitiveness.
- The benefits of subsidies are concentrated in the hands of a limited number of beneficiaries; costs are borne by all tax payers.

3. A political challenge

- Vested interests
- Acquired power of public financing institutions.
- « Rent-seeking »
- Fear of political hurdle, if subsidies are removed.
- « Subsidy addiction » or claim for a “subsidy right”.
- Lack of transparency on volume size of subsidies, beneficiaries, real cost, social implications etc.
- Poor data reporting at international level
- Political leadership needed at national and international levels.

4. A social challenge

Phasing out subsidies raises social concerns (e.g. water, energy)

- A number of subsidies aim to protect specific social categories (farmers, fishers, transport etc.)
- Subsidies for regional development.
- Support to employment.
- In cases of under-pricing or taxing, compensation measures are preferable to mitigation.
- Fossil fuel subsidies benefit more to richest categories which consume relatively more energy.

An international commitment

G20 September 2009 (Pittsburgh)

- Rationalise and phase-out inefficient and harmful fossil fuel subsidies
- Governments should develop implementation strategies.
- Requests OECD, WB, IEA and OPEC to provide analysis and suggestions for implementation (see June 2010 joint report).

European Commission

- Launched a statistical and methodological program (by sector).
- However, does not envisage a subsidy phase-out plan.

Conclusions

- The issue of subsidies is at the core of sustainable development:
 - Environment and resources
 - Economic efficiency
 - Social equity
 - International equity (with DCs)
- These difficulties and obstacles must imperatively be overcome.

Reforming or phasing out subsidies offers huge “win win” opportunities on:

- environmental,
- resources,
- Economic,
- Public finance
- and social grounds.

➔ Exploit windows of opportunity such as tax reforms.

- Reform will require:
 - Time and a gradual approach.
 - A holistic view : economic, social, environmental, fiscal, international.
 - An inter-sectoral governance
 - A strong political will.

The present economic crisis could provide an opportunity for reform.

➤ ***Will it be utilised ?***