Report to Leaders
on the G20 Commitment to Rationalize and Phase Out Inefficient Fossil Fuel Subsidies

Executive Summary

At the Pittsburgh Summit, G20 Leaders committed to rationalize and phase out over the medium term inefficient fossil fuel subsidies that encourage wasteful consumption. To deliver on this commitment, many G20 countries have developed strategies and timeframes for implementing national–level policies to rationalize and phase out inefficient fossil fuel subsidies, including such measures as preferential tax incentives for oil production, financial support for domestic coal industries, and direct subsidies for fuel consumption. As requested by the G20 leaders, the IEA, OPEC, OECD, and World Bank provided a Joint Report analyzing the scope of energy subsidies and offering suggestions for implementing this initiative.

This paper demonstrates the commitment among G20 countries to rationalize and phase out inefficient fossil fuel subsidies while recognizing the importance of providing those in need with essential energy services. These efforts will enhance energy efficiency, promote energy security, and assist in the fight against climate change. This initiative has increased the transparency on reporting of fossil fuel subsidies, shed light on the full scope of energy subsidies, raised the profile of this issue in the international arena, and helped build momentum globally for fossil fuel subsidy reform. This momentum must be translated into action as countries implement the strategies reported here, continue work to further identify subsidies, and put in place policies to protect the poorest. Countries must resolve to carry this work forward if inefficient fossil fuel subsidies are to be reformed both within the G20 and beyond, and if the benefits of this reform are to be widely shared.

Introduction

Inefficient fossil fuel subsidies encourage wasteful consumption, distort markets, impede investment in clean energy sources and undermine efforts to deal with climate change. In recognition of these adverse effects, the Leaders at the Pittsburgh Summit committed to rationalizing and phasing out inefficient fossil fuel subsidies over the medium term. In light of this commitment, Leaders called on their Energy and Finance Ministers to develop implementation strategies and timeframes, based on national circumstances. Ministers were further asked to offer a report at the next Summit. At the St. Andrew's meeting, the G20 Finance Ministers initiated a process for rationalizing and phasing out fossil fuel subsidies. In January 2010, the G20 established an informal experts group on energy, in which all 20 countries participated in an open and constructive manner. The G20 energy experts, under the supervision of the Finance and Energy Ministers, have determined a timetable for the process, comprehensively reviewed fossil fuel subsidy programs in their own countries, assessed the efficiency of each program, and, finally, have developed strategies and timeframes for rationalizing and phasing out inefficient fossil fuel subsidies. In addition, the G20 had also asked four international organizations (IOs) – the IEA, OPEC, OECD, and World Bank – to submit a joint report analyzing the scope of energy subsidies and offering suggestions for the implementation of this initiative. That report is now complete.

Summary of the Joint Report

The Joint Report assessed the use of energy subsidies by governments and analyzed their scope. Subsidies are one of many policy instruments used by governments to attain economic, social and environmental objectives. Energy subsidies, in particular, are often used to alleviate energy poverty and promote economic development by enabling access to affordable modern energy services. Yet poorly implemented energy subsidies are economically costly to taxpayers and can encourage wasteful use and damage the environment through increased emissions of greenhouse gas and other air pollutants. The IEA estimates that subsidies related to fossil-fuel consumption amounted to over US$ 500 billion in 2008.[1] If these subsidies were phased out by 2020, primary energy demand at the global level would be reduced by 5.8% and energy-related carbon-dioxide emissions would be reduced by 6.9%, compared with a baseline in which subsidy rates remain unchanged. The Joint Report states that production subsidies may be on the order of US$ 100 billion per year globally, while noting that no systematic effort has been undertaken within the last decade to estimate subsidies to fossil-fuel production over a wide range of countries. Production subsidies are more difficult to identify and quantify, and the IOs will continue with further work in this area. The Joint Report

[1] However, the Joint Report noted that the price-gap methodology has shortcomings. OPEC suggests that the benchmark price to be used in the case of energy resource well-endowed countries should be the cost of production.

also found that OECD countries have been raising taxes (negative subsidies) on energy, mainly fossil transport fuels, in amounts exceeding US$400 billion (excluding GST and VAT) in each of the years between 2003 and 2008. Subsidies to other non-fossil fuel energy was also found to be considerable, with the Global Subsidies Initiative (GSI) estimating that US$100 billion per year is spent to subsidize alternatives to fossil fuels. Based on this, OPEC estimates that renewable energy sources and biofuels are subsidized at a much higher rate than fossil fuels.

The Joint Report provides a roadmap to guide policy makers going forward, based on lessons drawn from case studies on subsidy reform in both developed and developing countries. Increasing the availability and transparency of energy subsidy data was cited as an essential first step in helping overcome challenges to the subsidy removal. As reforms are implemented, particular attention needs to be paid to addressing political obstacles and affordability constraints. Governments can facilitate the reform process by providing reliable, well-targeted, and transparent support to vulnerable populations, including social safety nets for poor households and restructuring packages for affected industries. However, since it may take time to put in place effective social safety nets, governments may want to consider alternative, short-term policies to assist the poor during the transition, including temporarily maintaining universal subsidies on those fuels that are better targeted to the poor and are more important in their household budgets. Addressing consumption patterns by promoting public transport and rationalizing the fuel mix for electricity and transport by switching from traditional fuel to modern sources are also key policies for successful reform.

Strategies and Timetables

To deliver on their commitment in Pittsburgh, G20 countries have developed strategies and timeframes for implementing national-level policies to rationalize and phase out inefficient fossil fuel subsidies. In view of the variety of energy subsidies worldwide, countries have developed implementation strategies based on national circumstances and definitions of what constitutes an inefficient subsidy in a country-owned process. Among the measures proposed for phase out by some countries are included such measures as preferential tax incentives for oil production, financial support for domestic coal industries, and direct subsidies for general fuel consumption. Countries have also proposed measures to mitigate adverse social impacts. Proposals under consideration by some countries are still subject to a domestic approval process by a legislative body, while other proposals are already being implemented by some countries. In addition, some G20 countries have already rationalized and phased out certain subsidies, and have been willing to share the lessons they have learned with fellow G20 countries.

All G20 countries actively participated in the process of identifying subsidies and developing implementation strategies for subsidy reform. Most countries prepared a list of their own fossil fuel subsidies and other fossil-fuel related provisions and shared this with other countries. As of June 11 when this report was finalized, nineteen countries or G20 members submitted information on actions concerning government policies towards fossil fuel producers or consumers.[2] Twelve countries submitted strategies and timetables to rationalize and phase out inefficient fossil fuel subsidies.[3] Brazil and China provided submissions that described domestic actions that will be taken with respect to existing measures that affect the consumption or production of fossil fuels, although both submissions noted that the existing measures are not inefficient fossil fuel subsidies. Six countries reported that they have no inefficient fossil fuel subsidies to reform in context of G20 mandate.[4] The European Union submitted a note describing the situation with regard to energy taxation and state aid in the EU as a complement to the submissions from individual EU countries.

The discussion below summarizes the reforms currently being undertaken or proposed by countries, categorizing them into three groups: reform of consumption-related subsidies, reform of production-related subsidies, and other measures.

Reform of consumption-related subsidies

Policies that support the consumption of fossil fuels were identified and proposed for phase out by a few countries.

[2] These 19 submissions are contained in Annex 2.

[3] These countries are Argentina, Canada, Germany, India, Indonesia, Italy, Korea, Mexico, Russia, Spain, Turkey and the United States.

[4] These countries are Australia, France, Japan, Saudi Arabia, South Africa and the UK. Australia, France, Saudi Arabia, and South Africa each provided submissions that summarized various aspects of national government policy on fossil fuels.

Mexico is currently implementing policies that are raising consumer retail prices for gasoline, diesel and liquefied petroleum gas (LPG), which under current market conditions are expected to eliminate any subsidy within a few years. Argentina is currently expanding household access to natural gas, and proposes to reduce subsidies for propane consumption as this is done. Indonesia plans to implement several reforms to limit consumption subsidies, including targeting subsidies at a limited set of sectors, providing incentives to shift from less-efficient fuels towards cleaner fuels, and increasing monitoring and sanctions for the misuse of subsidized fuels.

Reform of production-related subsidies

Subsidies for the production of fossil fuels represent the majority of subsidies that G20 countries have identified as inefficient and proposed for phase out. Many of these are implemented through a country's tax code. The United States is proposing to pass legislation that would eliminate preferential tax incentives for the production of coal, oil, and natural gas. China plans to gradually reduce the urban land use tax relief provided to fossil fuel producers using urban land for construction and production. Canada released draft legislation in May 2010 that will phase out the accelerated capital cost allowance for investment in oil sands assets over the 2011-15 period.

Some countries provide other types of budgetary support for production. Germany currently provides financial assistance to the hard coal mining industry, and will be phasing down these subsidies to discontinue them by 2018. Korea will be phasing out direct support for anthracite coal and briquette producers that compensates them for the difference between the cost of production and a regulated sale price, as well as allowing sale prices to gradually increase. Turkey will be continuing with its plan to restructure a state-owned coal mining enterprise and phase out the subsidies the enterprise has received through capital injections from the government. Spain also proposes to implement current coal industry restructuring plan until 2012 when further restructuring will be considered. And Italy will continue to previously established plans to gradually eliminate feed-in tariffs for certain cogeneration facilities, while also pursuing voluntary agreements with industry that would accelerate phase out.

In addition to the proposed reforms to existing subsidies, several G20 countries have previous experience with the phase out of production subsidies for fossil fuels that provide valuable lessons. In the United Kingdom, reform of subsidies for coal production was preceded by the privatization of state-owned companies. The removal of subsidies was accompanied by measures to stimulate economic development and create new job opportunities in affected areas, which helped maintain economic growth and increase support for reform. France also has experience eliminating subsidies for coal mining. In France an agreement to close coal mines was paired with extensive measures to promote alternative economic activity as well as long-term support for former miners. Although subsidies were eventually eliminated, this occurred largely because of the closing of coal mines, and the government still retains ongoing legacy costs of providing social support to former miners. Canada has in the past eliminated a number of tax preferences for fossil fuel producers. Factors that facilitated those reforms included advance notice to industry, transitional relief, and coincidental beneficial changes to the tax system.

Other measures proposed

Several countries have proposed measures that will accompany reform of inefficient fossil fuel subsidies. Several of these measures provide transitional assistance to vulnerable populations in the shift away from subsidies. For example, Korea expects to provide expanded briquette vouchers for low-income households as a complementary measure while phasing out subsidies for briquette producers. In Germany, the timeline for phase down of the subsidy for hard coal mining has been set such that gradual retirement of older workers will help cushion the impact of subsidy removal. Mexico is working on a census of fossil fuel use in households that will allow it to design and implement well-targeted cash transfer programs to compensate poor households for fossil fuel price increases.

Other accompanying measures involve a country commitment to pursue the rationalization and phase out of subsidies in the context of broader policy reforms or reviews that are ongoing. Russia's commitment to rationalize and phase out of inefficient fossil fuel subsidies becomes part of the national economic and energy policy and its strategy will be implemented within the framework of its Energy Strategy 2030 and other policy initiatives, as well as in the context of its WTO accession. India has constituted a group of ministers to recommend an implementation strategy and timetable. Other countries including Brazil and Italy have used the G20 commitment as an opportunity to affirm existing policies within their governments to reform policies concerning fossil fuel production or consumption. And while the submissions from some countries noted that they did not have any inefficient fossil fuel subsidies to phase out, they also provided additional information about national policies concerning fossil fuels. For example, Australia's submission noted that the government intends to phase-in excise taxes on certain fuels to improve the efficiency of the fuel tax system. Saudi Arabia's submission summarized the government's energy policy to improve the utilization of non-renewable natural resources, with emphasis on rationalization, to ensure the sustainability of long-term consumption. And South Africa′s submission noted recently introduced electricity tax that applies to electricity generated from non-renewables as well as other relevant tax measures and incentives to reduce wasteful consumption and encourage clean energy development.

Conclusion

The strategies submitted by G20 countries for phasing out and rationalizing inefficient fossil fuel subsidies could provide significant benefits, including enhancing economic and energy efficiency, improving fiscal balances, and reducing GHG emissions that contribute to climate change. Realizing these benefits, however, will depend on countries following through and implementing the reforms they are currently proposing. In Pittsburgh, Leaders called on all nations to adopt policies that would phase out inefficient fossil fuel subsidies worldwide. Much work remains if inefficient fossil fuel subsidies are to be reformed both within the G20 and beyond, and if the benefits of this reform are to be widely shared.

In addition, the work that has been undertaken to deliver on the commitment from Pittsburgh has enhanced cooperation among our respective Finance and Energy Ministries, increased the expertise and proficiency of our Finance Ministries on energy policy, and created a regular dialogue among G20 members on energy issues. Leaders may want to consider whether this dialogue should be continued, and what useful role it could play. At Pittsburgh, the commitment to rationalize and phase out inefficient fossil subsidies that encourage wasteful consumption was taken in light of broader objectives of enhancing energy efficiency, promoting energy security, and fighting climate change. Further, the subsidies commitment was paired with recognition of the importance of providing those in need with essential energy services. And beyond rationalizing and phasing out inefficient fossil fuel subsidies, Leaders also committed at Pittsburgh to stimulate investment in clean energy, renewables, and energy efficiency; provide financial and technical support for such projects in developing countries; increase access to energy for the poor; and promote energy market transparency and market stability to avoid excessive volatility. Any of these objectives or commitments could prove to be rich ground for further collaboration, subject to agreement by all members, among energy experts in our Governments.

ANNEXES

Annex 1: Table summarizing the strategies and timetables submitted by G20 countries

Annex 2: The strategies and timetables submitted by G20 countries for rationalizing and phasing out inefficient fossil fuel subsidies (including the list of measures considered for phase out, from those countries that chose to make this list public)