Challenges and opportunities for the reform of fossil fuel tax expenditures in developing and emerging economies

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Outline

1. What are fossil fuel tax expenditures (TEs)?
2. Why do governments provide them?
3. Why should they be reformed?
4. How can they be reformed?

What are subsidies?

WTO definition

A financial contribution by a government or any public body… where a benefit is conferred.

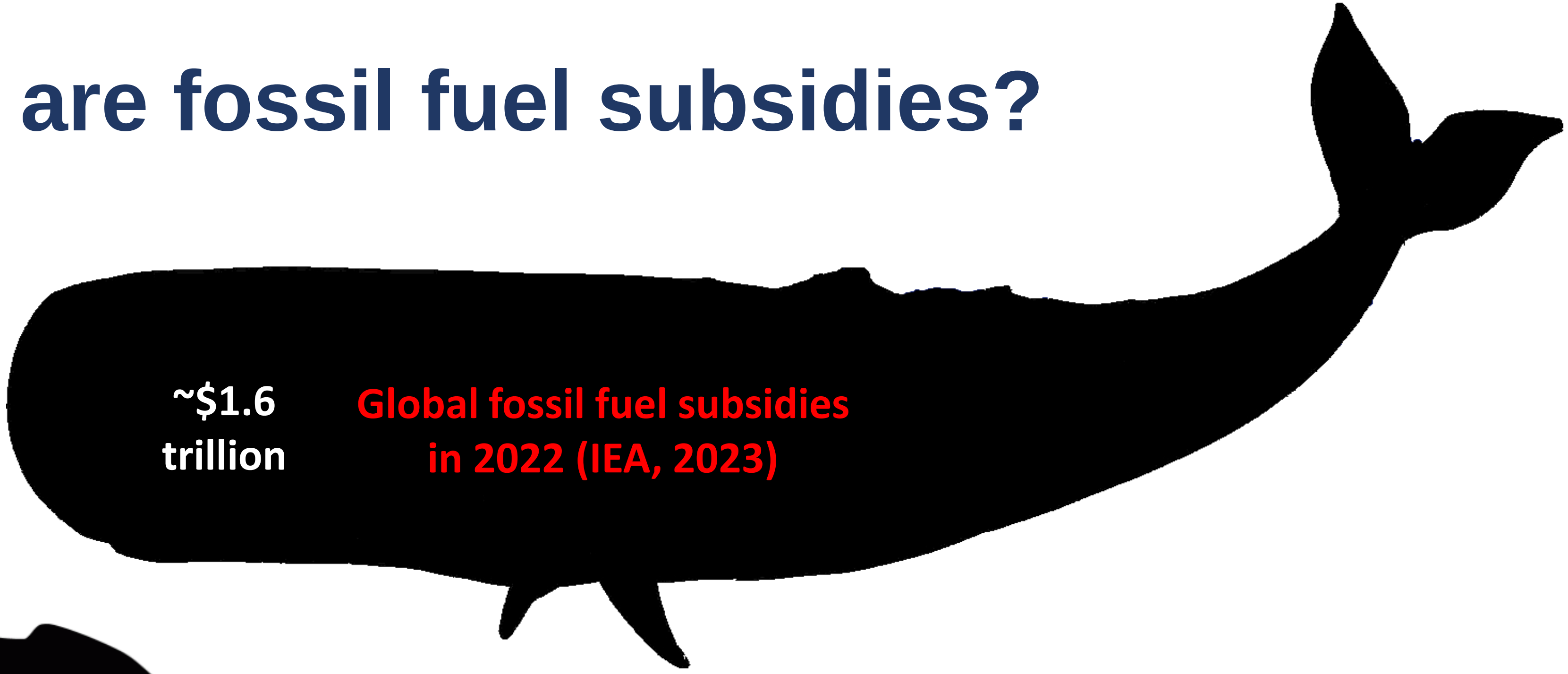
Category	Fossil fuel example
Direct transfer of government funds	Allocation in the annual national budget to build a new LNG terminal
Tax expenditure, other revenue foregone, and underpricing of goods and services	Lower corporate tax rates for oil and gas producers
Induced transfers (price support)	Selling fuel domestically for USD 0.50/l when the international market price is USD1/l
Transfer of risk to government	Failure to impose a sufficient bonds for mine or drill site remediation

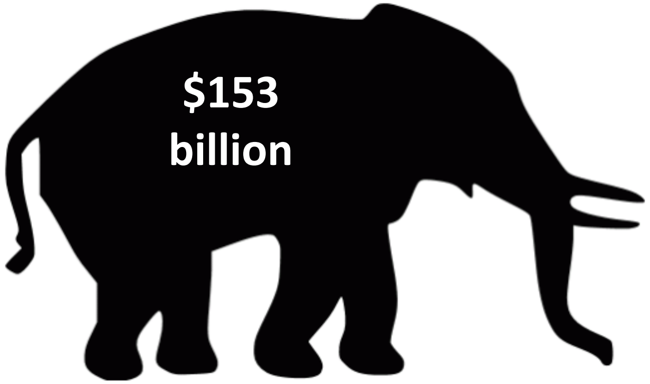
Types of fossil fuel tax expenditures

Image Source: [Mikulka, 2021]

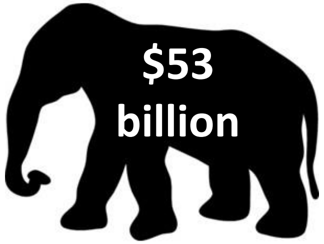
- Producers
  - reduce cost of producing coal, oil or gas.
  - E.g.
    - CIT deductions or credits for exploration and development expenses
    - Tax deductions on capital equipment
    - Preferential treatment of capital-gains
    - Credits for R&D
- Consumers
  - lower price of fossil fuels for consumers.
    - E.g. cuts to excise tax, GST, VAT, import duties

How big are fossil fuel subsidies?

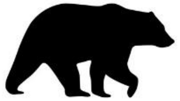




Tax expenditures (OECD 2021 estimate, 42 countries)



Tax expenditures in 12 largest developing and emerging economies (OECD 2021 estimte)



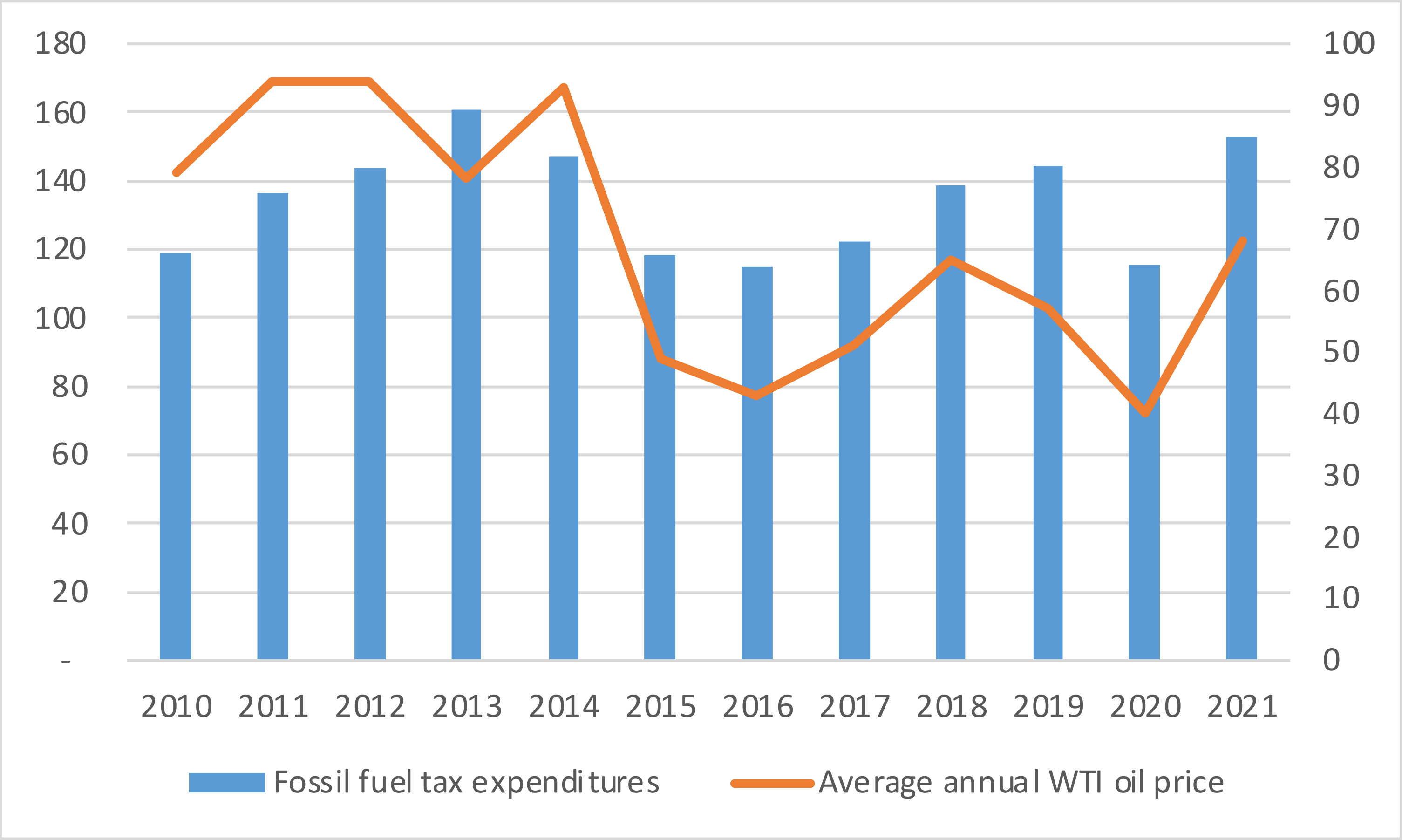
$6 billion

Tax expenditures in 39 developing economies (2015-2020 GTED estimate)

Data sources: (Aliu & Redonda, 2022) (IEA, 2023) (OECD, 2022)

Fossil fuel TEs follow the oil price…

Likely to see huge increase in 2022



Source: OECD Inventory of Support for Fossil Fuels, 2022

Trends during covid and energy crisis

India example

COVID

- oil price
- Government increased fuel taxes
    - generate revenue for response and recovery

Energy Crisis

- Oil prices
- Government reduced fuel taxes
    - foregone revenue ~ USD 28 billion per year
- windfall profits tax on oil exporters

Image source: Hindustan Times, 2021

Why governments provide fossil fuel tax expenditures

Consumer subsidies

- Increase energy access
- Lower prices for electricity generation and industry

Producer subsidies

- Foster domestic supply & increase energy security
- Attract investment
- As a secondary effect—increase government revenues through FF royalties and corporate taxes

Why phase out fossil fuel tax expenditures?

Impacts often hard to assess due to poor transparency

1. Erode government revenues
   - Revenue could be put to more effective uses
2. Exacerbate negative impacts of fossil fuels
   - Real costs to society
3. Distort markets
   - Artificially lower prices
   - Lock-in ongoing production
   - Create an un-level play field
4. Not an effective way to reduce poverty
   - Wealthiest get the most benefits
5. Undermine energy security

Fossil fuel subsidies and the SDGs

SDG	
1 NO POVERTY	• Fossil fuel subsidies disproportionately benefit wealthier households • Subsidy reforms in combination with targeted social welfare programmes can address poverty
3 GOOD HEALTH AND WELL-BEING	• Outdoor air pollution estimated to cause 3 million premature deaths worldwide in 2012 • Removing subsidies and taxing fossil fuels could cut global air pollution by half
5 GENDER EQUALITY	• Women often do not benefit directly from fossil fuel subsidies • Social welfare programmes and targeted cash transfer can be designed to empower women
7 AFFORDABLE AND CLEAN ENERGY	• Subsidies can hinder the uptake of new low-carbon technologies • Risk of creating stranded assets
13 CLIMATE ACTION	• Fossil fuel subsidy reform could result in significant emissions reductions. • Risk of creating stranded assets
12 RESPONSIBLE CONSUMPTION AND PRODUCTION	• Decoupling economic growth from natural resource use is fundamental. • Removing fossil fuel subsidies reduces the global demand for fossil fuels

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TIME FOR GLOBAL ACTION

Most major economies committed to reform

Inefficiency has not been defined

Year		Commitment
2009	G20	Phase out inefficient fossil fuel subsidies
2016	G7	Phase out inefficient FFS by end 2025
2021 & 2022	UNFCCC COP	Accelerate efforts to phase-out inefficient FFS
2022	WTO Ministerial Conference	47 Members pledged to discuss options for supporting FFS reform

Pre-crisis reforms in D&E economies

5 economies that reduced fossil fuel TEs or significantly increased fossil fuel taxes

India	Gradually increased excise & VAT on gasoline and diesel	2010 to 2021
The Philippines	Increased fossil fuel taxes accompanied by cash transfers	2018 to 2020
Saudi Arabia	Introduced 5% VAT on all goods including transport fuels, increased to 15%	2018-2020
Indonesia	Removed VAT exemption on domestic coal sales	2020
South Africa	Increased carbon tax rate	2022

The Way Forward: Consumer TEs

Image source: World Bank, 2017

- Shift support from fuels to people
  - invest in welfare and tax systems to deliver alternative forms of targeted support
  - use subsidy savings
- Address political economy challenges
  - improve the social contract between citizens and government
- Provide clean energy and transport alternatives
- use other tools to fight inflation

The Way Forward: Producer TEs

Source: ShanghaiDaily.com, 2016

Shift support to clean energy

Address economic, social and political economy challenges

- FF dependent communities and businesses
- Promote economic diversification
- Promote economic and job benefits of diversification into renewable energy

- Build understanding in the broader community
- Learn from past reform efforts

The Way Forward: Timing

High fossil fuel prices

- Remove tax incentives for exploration and production
- Implement windfall profits tax
- Prepare to phase out consumer TEs when international prices start to fall

Increase transparency!

Image: Westlight/Shutterstock

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The Way Forward: Comprehensive reform strategy

- Increase transparency
- Consultation with stakeholders and the public
- Communication of the costs of TEs and the benefits of reform
- Compensation
  - ameliorate impacts
  - increase political support