Reforming Fossil Fuel Subsidies to Mobilize Climate Finance

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Plan of talk

- Fossil fuel subsidies deter climate finance

- Issues
  - definition and size of subsidies
  - how to move forward
2 types of energy subsidies

- ‘pre-tax’ subsidies—domestic price < supply cost
- ‘post-tax’ subsidies—also includes implicit subsidy from failure to charge for environmental damages

Measured in IMF (2013) by

- price gap approach
- first-pass extrapolation of damages from case studies

Eliminating post-tax subsidies (i.e., getting prices right) is critical for mobilizing green investment
Pre-Tax Energy Subsidies, 2011

By region:
- Sub Sah. Africa, 4%
- Middle East and North Africa, 48%
- Latin America, 7%
- Emerging and Developing Asia, 21%
- Cent. & East. Eur., Common. of Indep. States, 15%
- Advanced, 5%

By fuel type:
- Petroleum, 44%
- Natural gas, 23%
- Electricity, 31%
- Coal, 1%
- Petroleum, 44%
- Natural gas, 23%
- Electricity, 31%
- Coal, 1%
Post-Tax Energy Subsidies, 2011

By region:
- Advanced, 32%
- Mid East, North Africa, 19%
- Latin America, 5%
- Emerging and Developing Asia, 29%
- Cent. & East. Eur., Common. of Indep. States, 12%
- SS Africa, 2%
- Mid East, North Africa, 19%

By fuel type:
- Petroleum, 37%
- Natural gas, 19%
- Coal, 36%
- Electricity, 9%
- Emerging and Developing Asia, 29%
- Cent. & East. Eur., Common. of Indep. States, 12%
- Advanced, 32%
- Petroleum, 37%
Impacts of Subsidy Reform

- Large fiscal dividend
  - removing post-tax subsidies would raise revenues of 2.5% of GDP or 8% of tax revenue

- Reduce CO$_2$ emissions 13%

- Substantial health benefits
  - properly pricing energy would eliminate most 3.2 million premature deaths (e.g., through control technologies at coal plants)
Distribution of Petroleum Product Subsidies

Source: Arze del Granado et al. (2010)
Several Ingredients for Successful Reform

- Clarify long-term objectives (e.g., price liberalization)
- Communicate size of subsidies and benefits of reform
- Depoliticize energy pricing
- Compensate vulnerable groups
  - low-income households, trade sensitive firms
  - requires research on distributional effects (input/output tables, household spending data)
Using Donor (Climate) Finance

- Conventional (IMF) view
  - role in funding fixed costs of reforms (e.g., database, computers, pilot programs for social safety nets)
  - not for ongoing spending (e.g., transfer payments) -- need to be self-sustaining from domestic revenues

- Maybe some role to reward good practice(?)
  - but first priority is to develop internationally acceptable metrics for comparing countries performance, like effective taxes on CO$_2$ (OECD 2013)