



# Principles for Designing Effective Fossil Fuel Subsidy Reforms

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# Background: FFS & Types

Any policy action that targets **Fossil Fuels** or **Fossil fuel-based electricity or heat** causing the following:

- Reduction in **Net Energy Costs**
- Reduction in **Energy Production/Distribution Costs**
- Increase in **Revenues of Energy Suppliers**

Consumer Subsidies	Producer Subsidies
<ul style="list-style-type: none"><li>• Fiscal measures that lower the price of fossil fuel products</li><li>• Making products affordable to end users</li></ul>	<ul style="list-style-type: none"><li>• Explicit: Direct payments or tax exemptions</li><li>• Implicit: Government guarantee of safeguarding investments</li></ul>

# Fossil Fuel Subsidy Reforms:

## Lessons for Policy Practitioners:

### **Communication and Compensation**

- Lack of compensation hurts the households and firms
- Public outreach campaign is crucial
- Cash transfers are an effective tool

### **Strengthen Social Protection Systems**

- Improve the effectiveness and cash delivery for developed countries
- Establish social protection for other countries

### **Establish Transparent Systems**

- Ensure reinvestment of reform revenues
- Align with country's long term goals
- Redistribute in managing natural resources

### **Manage energy price volatility**

- Implement smoothing measures and smart timing
- Continued even after the subsidy reform
- Help stabilize domestic energy prices through fluctuations

**Complementary Policies are equally important**

# Adverse Effects of FFS

Aggravate Fiscal Imbalances

Crowd out other productive investments

Energy Shortages

Fuel Adulteration and Smuggling

Overconsumption

Reduced motivation for Energy Efficiency

Reduction in use of Renewables



# Assessment of Subsidies

## Global Subsidies Initiative Framework (GSI, 2010)



Definition and  
Identification of  
Existing Subsidies



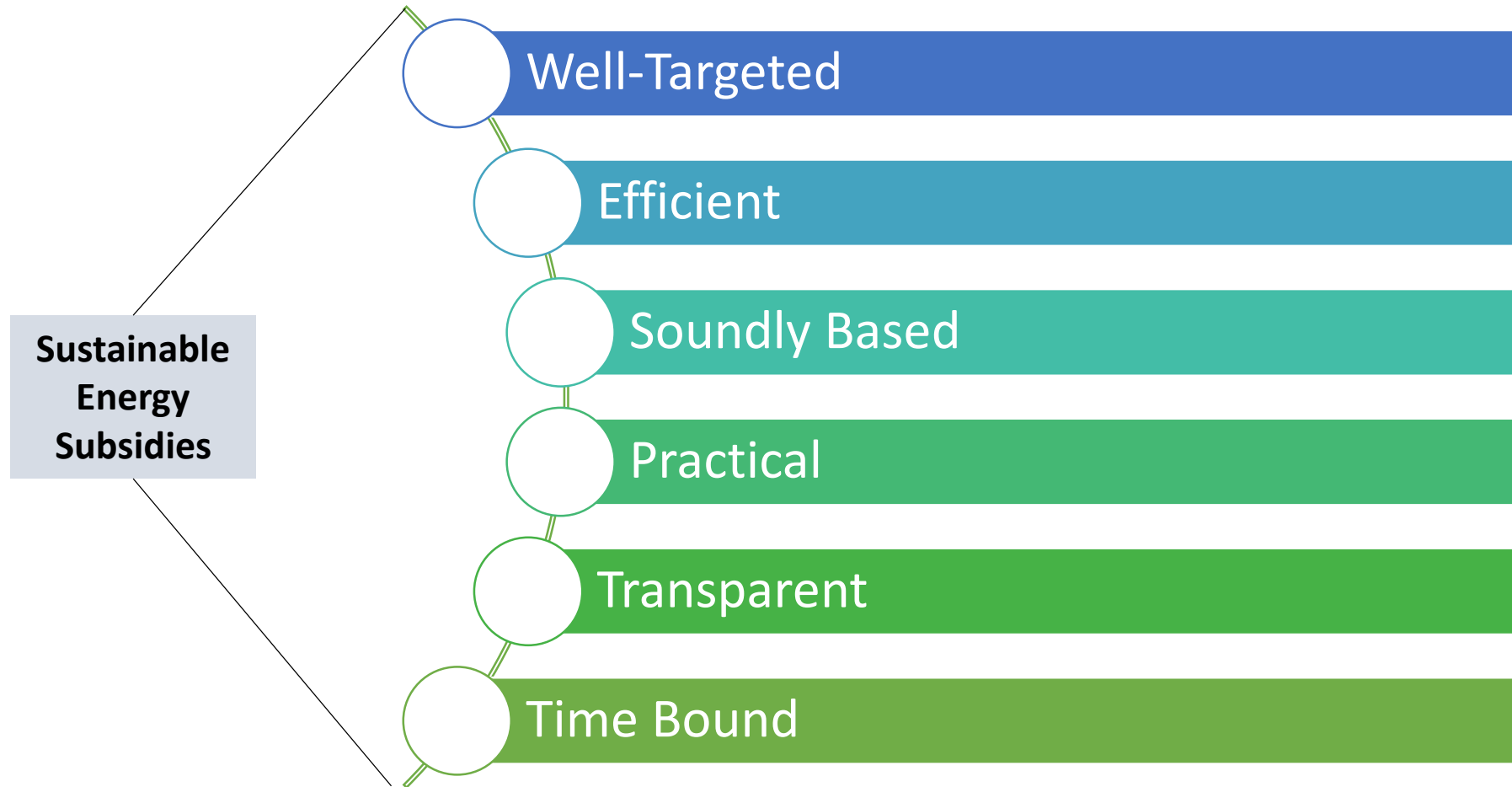
Quantitative  
Measurement &  
Estimation



Assessment &  
Established Need  
for Reforms

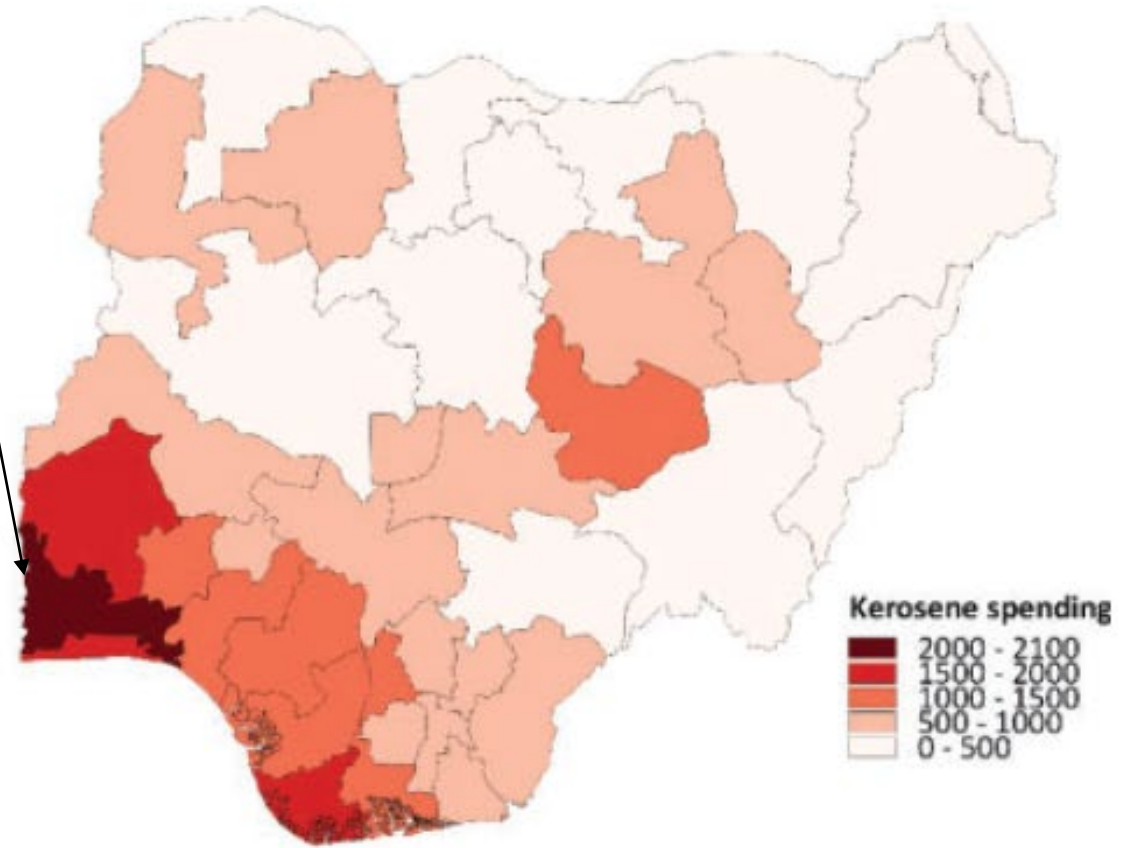
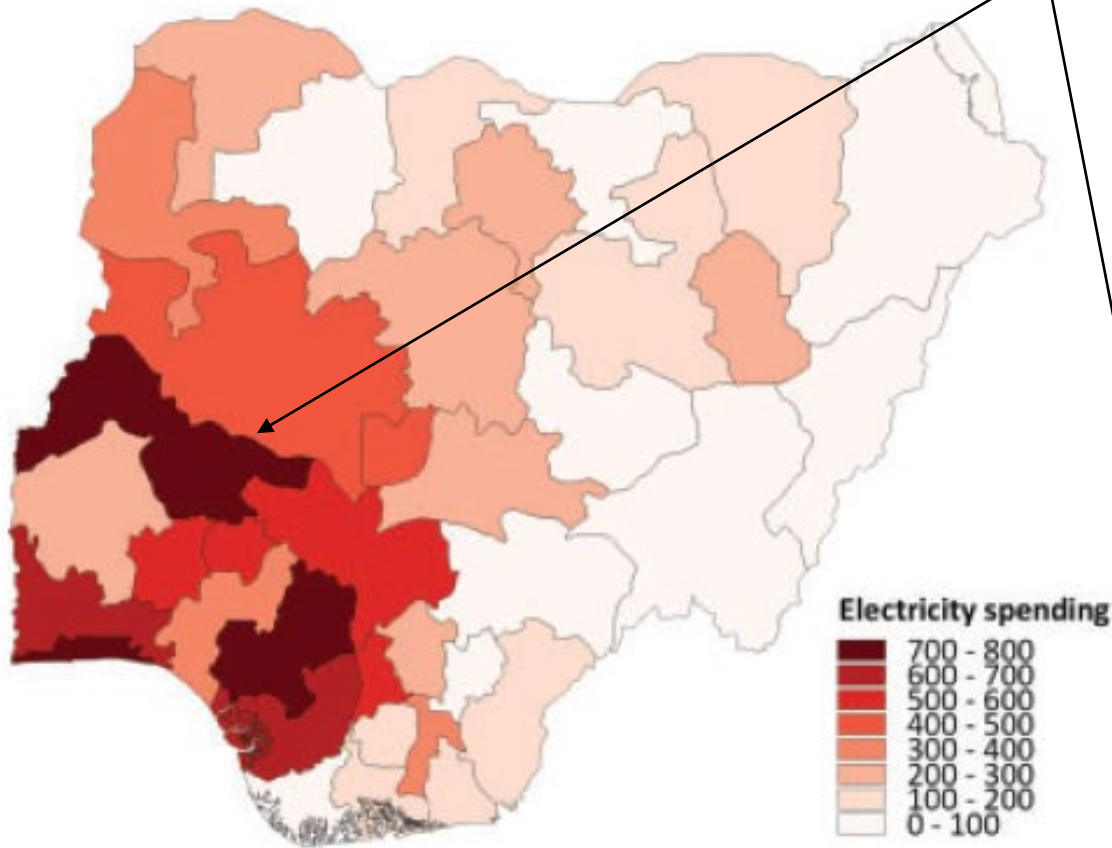
# Assessment of Subsidies

**United Nations Environment Program (UNEP,2003)**



# Focusing on Diversity: A Case Study

Different Employment Types, Access to energy, Availability of Alternate fuels



**Average monthly spending on energy goods by Nigerian households living in absolute poverty, by state and in Naira per month.**



# Revenue Redistribution & Reinvestment

Necessary to allocate revenues in accordance with long term development and public finance strategy



## Domestic or International Investments

- To generate future revenue system
- Developed countries should aim for local investments (education, healthcare)
- Developing countries should aim to invest in natural resources domestically



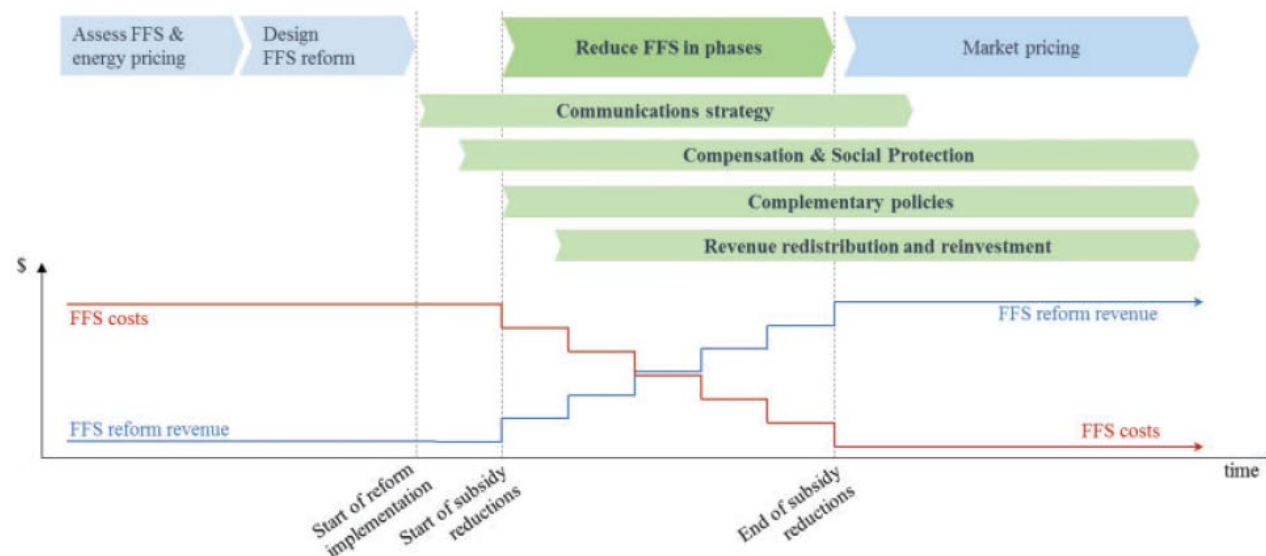
## Monetary Respite

- Permanent cash transfer to compensate for vulnerable households
- Complementary tax reform through double dividend
- Environmental taxes are increased but other taxes are reduced, then environmental benefits can be reaped with additional fiscal efficiency

Other Complementary Redistribution strategies are also country specific



# Timing and Price Smoothing



- Potential for a reform to be successful depends on external factors such as fuel prices and political circumstances
- For India (2014) and Indonesia (2014), political will for reform with low oil prices
- The timing is crucial for determining when and how to implement reform
- For Iran, which phased in subsidy reductions over 5 years, showing gradual adjustments and well-timed reform measures can be successful
- “Price smoothing” is necessary during and after the reform period

# Conclusion

- Success rate of reforms is improved through strong government commitment and credibility, careful reform design, effective communication and smart timing
- Governments should equally focus on managing the downside risks of reforms and maximizing the development potential associated with the reform
- Reinvestment and redistribution of revenues is critical for long term goals
- There is a need for a variety of policy measures apart from a purely fiscal task
- Multisector collaboration is the key for successful reforms

THANK YOU