Fiscal Policy and the Environment

May 2013

Plan of Presentation

- **Why fiscal instruments (environmental taxes, ETS with allowances sold)?**

- **Energy subsidy reform: lessons and implications**

I. Why Fiscal Instruments?

Fiscal instruments are environmentally effective

- **They exploit all—and strike right balance between—emissions mitigation opportunities:**
- **E.g., a carbon tax**
  - promotes fuel switching in power generation
  - reduces demand for electricity, transportation fuels, heating fuels

- **Regulatory policies are much less effective:**
  - renewables mandate (misses some fuel switching opportunities in power sector)

Design issues in environmental taxation

- ***Level of charges***
  - charges should reflect environmental damages from carbon and local pollution
  - motor fuel taxes should also reflect congestion, accident, and road damage (with long-term transition to mileage-based taxes)

II. Energy Subsidy Reform

Consequences of energy subsidies go well beyond fiscal costs

- **Depress growth**
  - reduce investment in the energy sector
  - crowd-out critical public spending
  - over-allocate resources to energy intensive sectors
- **Create negative externalities (for example, global warming)**
- **Reinforce Inequality**

Measurement of energy subsidies

- **Pre-tax subsidies** exist when energy consumers pay a price below the supply cost of energy, including transportation and distribution costs

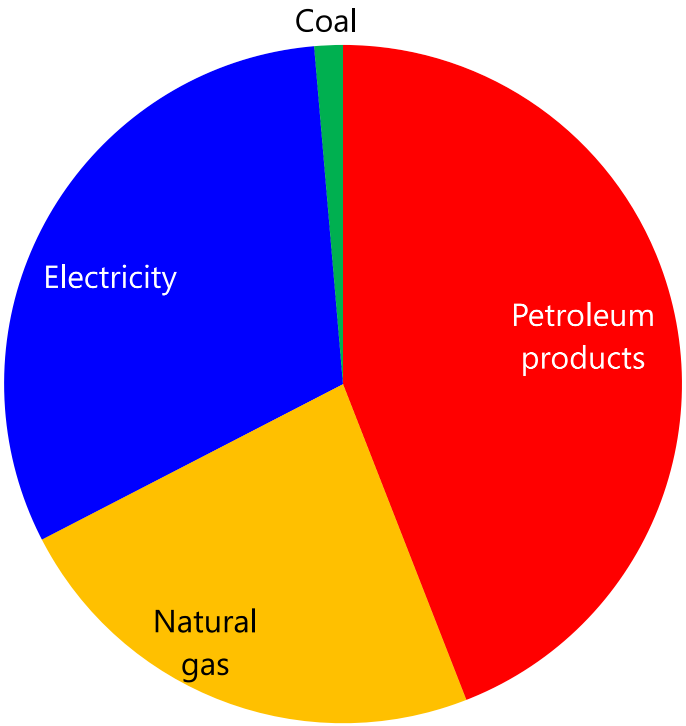
- **Tax subsidies** arise if energy taxes are too low: energy should be taxed the same way as any other consumer product, plus additional taxes to account for the adverse effects of energy consumption

- **Post-tax subsidies** equal pre-tax + tax subsidies

Post-tax subsidies are large, with more than a quarter from coal

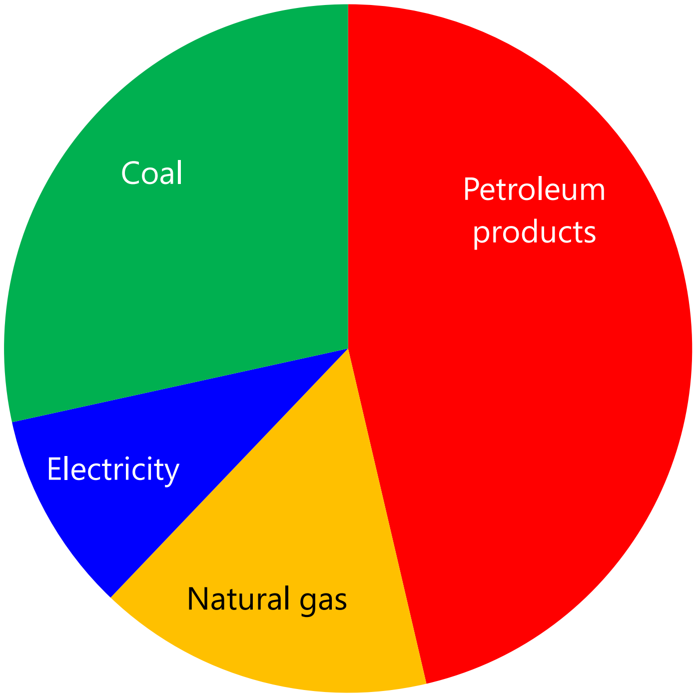
- Pre-tax

$480 billion (0.7% GDP, 2.1% revenues)



- Post-tax

$1.90 trillion (2.7% GDP, 8.1% revenues)



Sources: IEA *World Energy Outlook 2012*; OECD; World Bank; and IMF staff estimates.

Advanced economies account for 40 percent of post-tax subsidies

- Pre-tax

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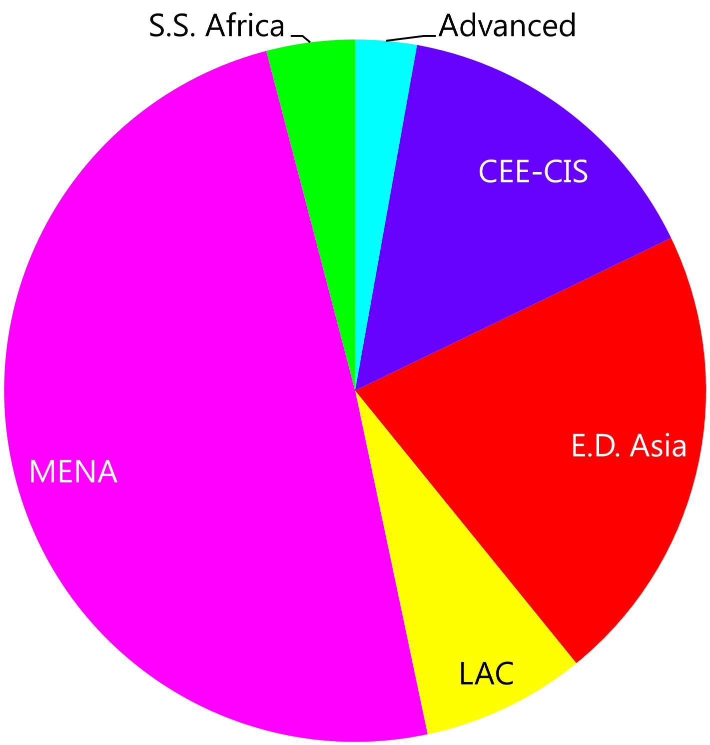

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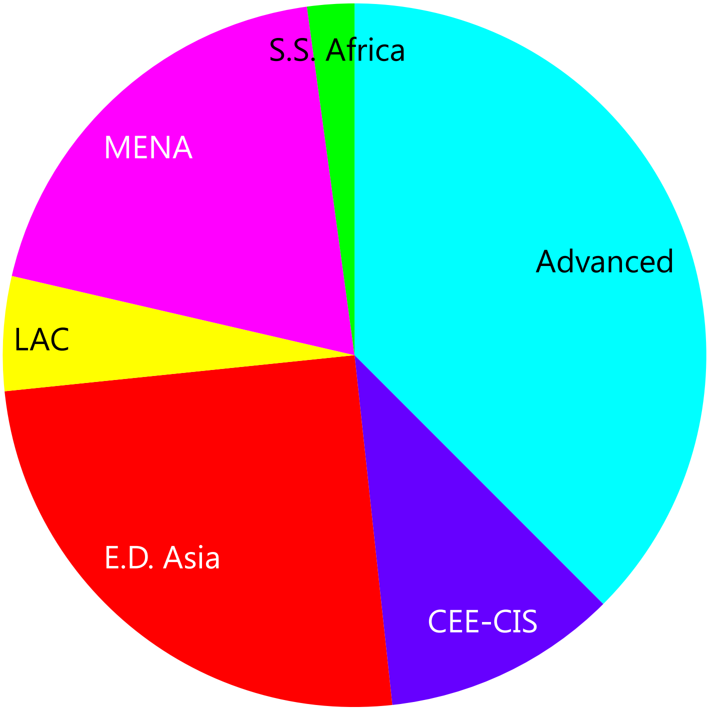
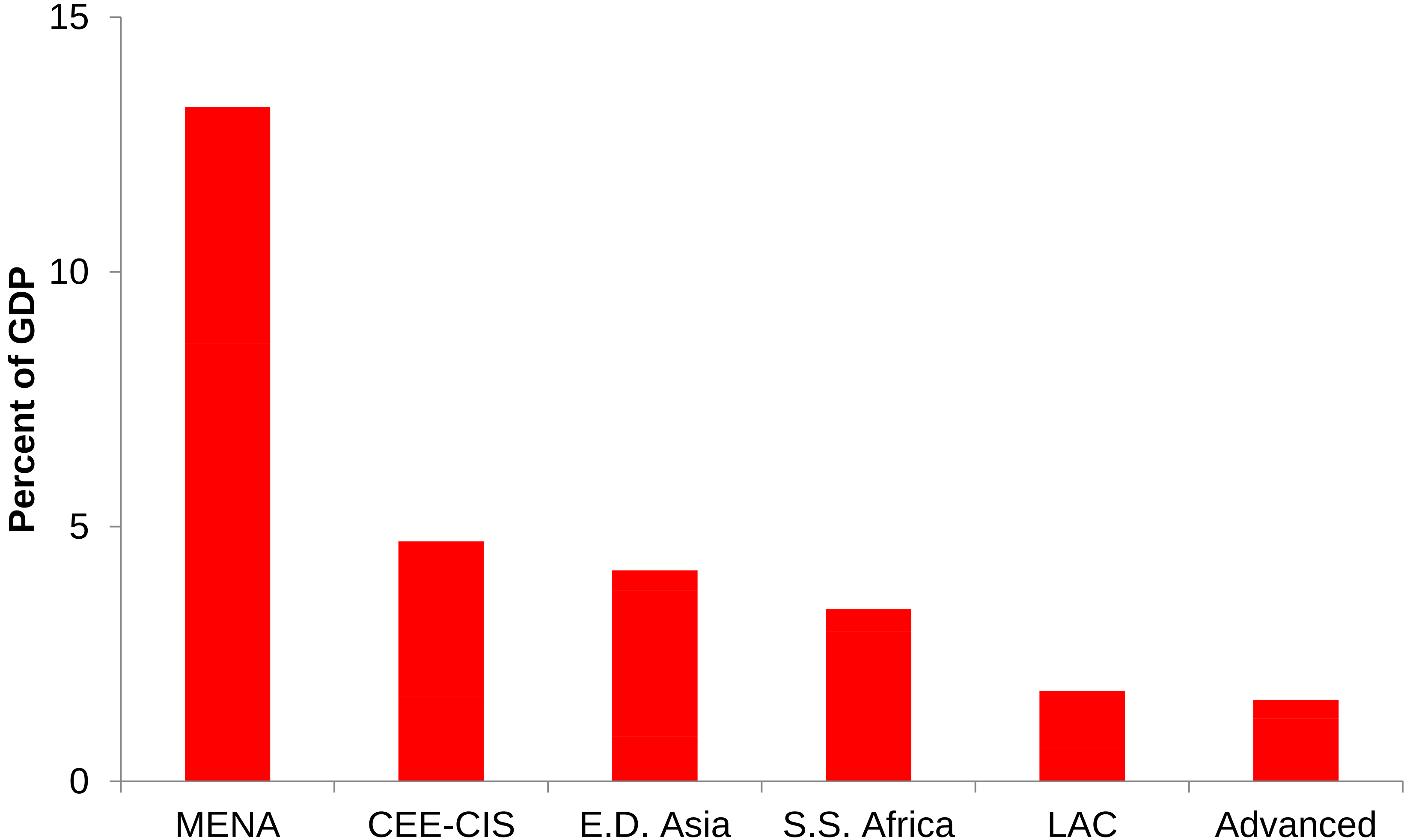


Sources: IEA *World Energy Outlook 2012*; OECD; World Bank; and IMF staff estimates.

As a share of GDP, post-tax subsidies are high in MENA and low in advanced economies



Sources: IEA *World Energy Outlook 2012*; OECD; World Bank; and IMF staff estimates.

Six key reform ingredients of subsidy reform

(i) A comprehensive reform plan

- clear long-term objectives
- assessment of the impact of reforms
- consultation with stakeholders

(ii) A far-reaching communications strategy

- inform the public of the size of subsidies and benefits of reform
- strengthen transparency in reporting subsidies

Six key reform ingredients

(iii) Appropriately phased and sequenced price increases

- permit households and enterprises time to adjust and governments to build social safety nets
- sequence increases differently across products

(iv) Improvements in the efficiency of state-owned enterprises (SOEs) to reduce their fiscal burden

- improve information on their costs, set performance targets and incentives, and introduce competition where appropriate
- improve collection of energy bills

Six key reform ingredients

(v) Targeted mitigating measures to protect the poor

- targeted cash transfers are preferred
- when cash transfers are not feasible, other programs can be expanded as administrative capacity is developed
- SOE restructuring may also require targeted measures (e.g., job training)

(vi) Depoliticize price setting

- implement automatic price mechanism (with price smoothing)
- establish an autonomous body to oversee price setting

- Additional details can be found at http://www.imf.org/external/np/fad/subsidies/index.htm

Thanks!