



STEP-BY-STEP GUIDE TO FOSSIL FUEL SUBSIDY RATIONALIZATION

for Developing Member Countries of the
Asian Development Bank

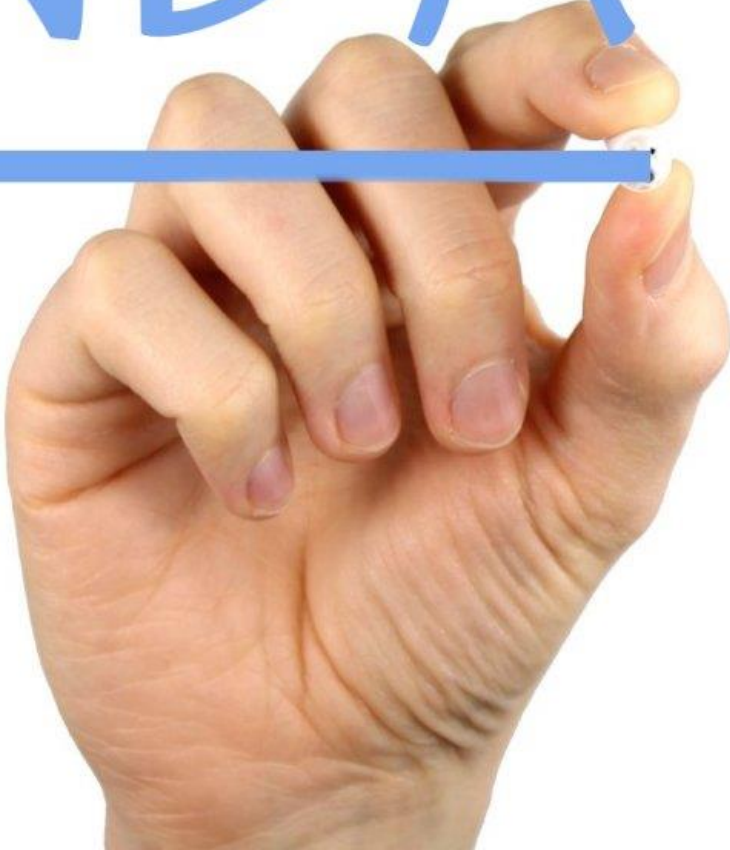
Webinar on Carbon Pricing and Fossil Fuel
Subsidies Reduction, Asian Development Bank,
Manila

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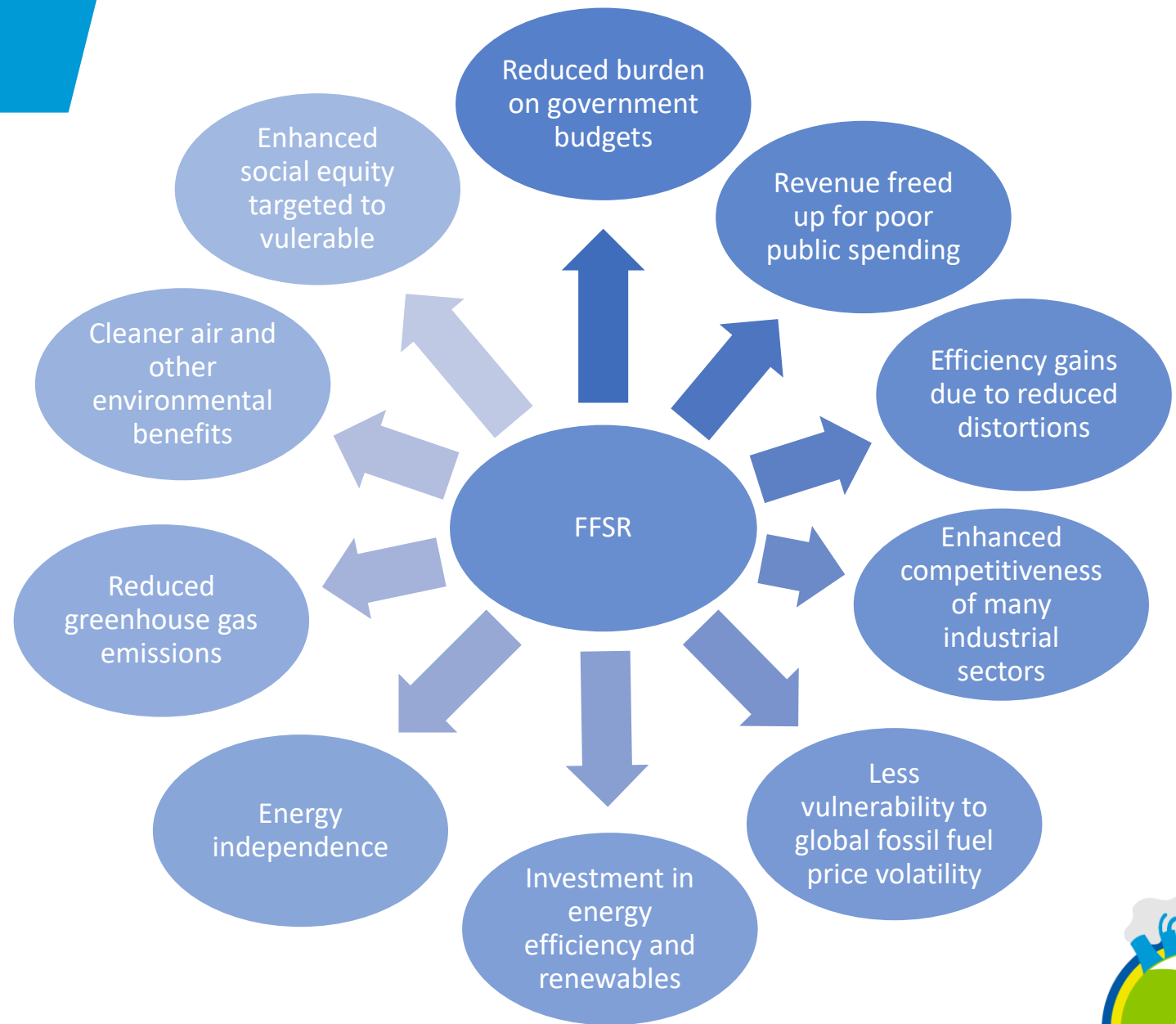
AGENDA



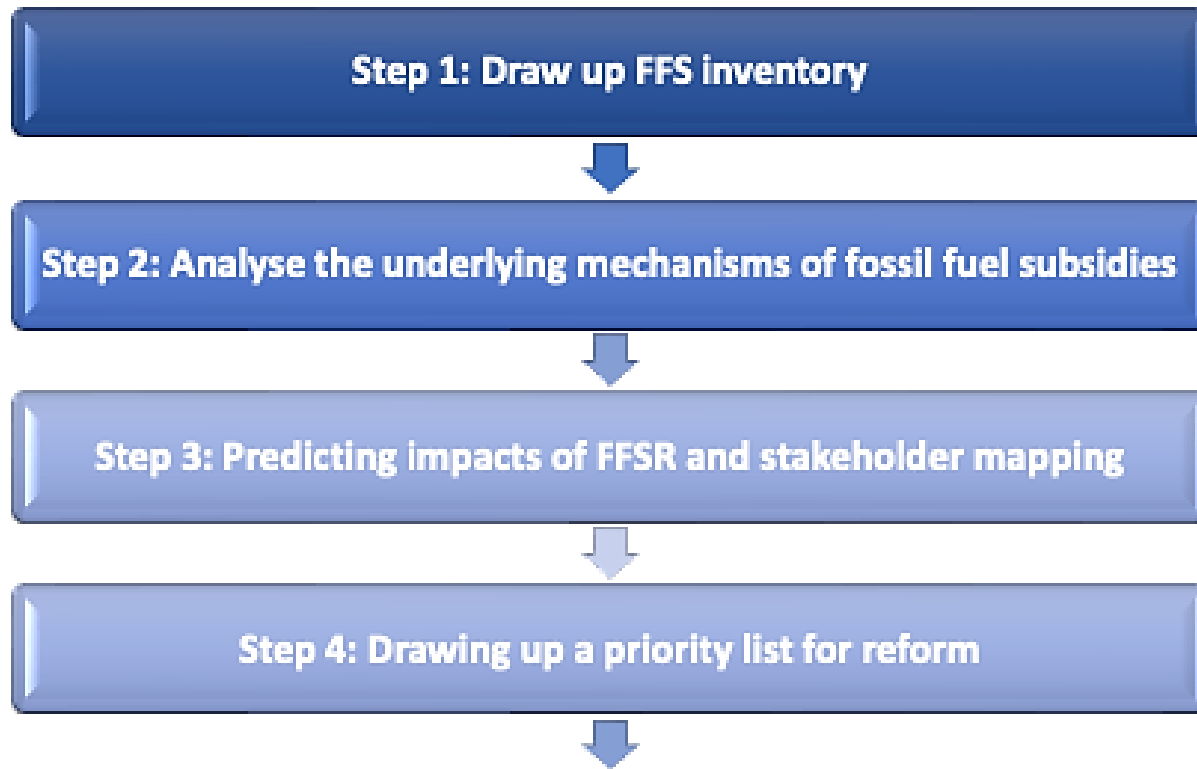
- Introduction to the step-by-step guide
- Preparing the ground for FFSR (steps 1-4)
- Strategic design considerations (step 5)
- Monitoring and adjustment (step 6)
- Concluding words

1) Introduction

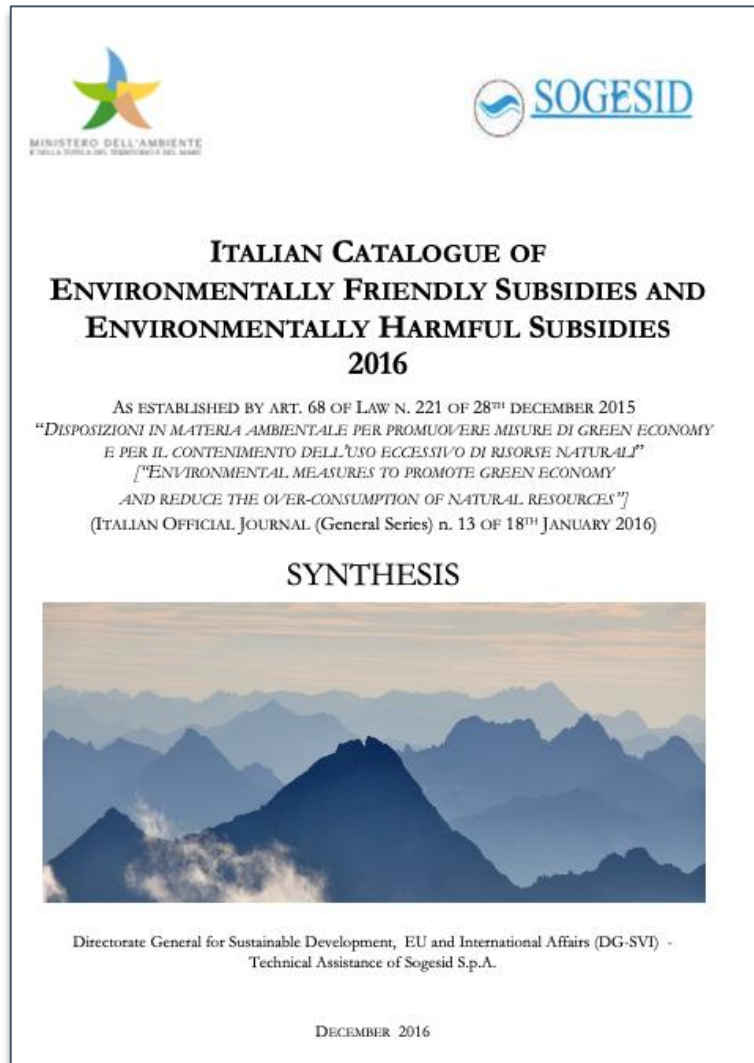
- Objectives
- Target audience
- Benefits of FFSR



A step-by-step approach



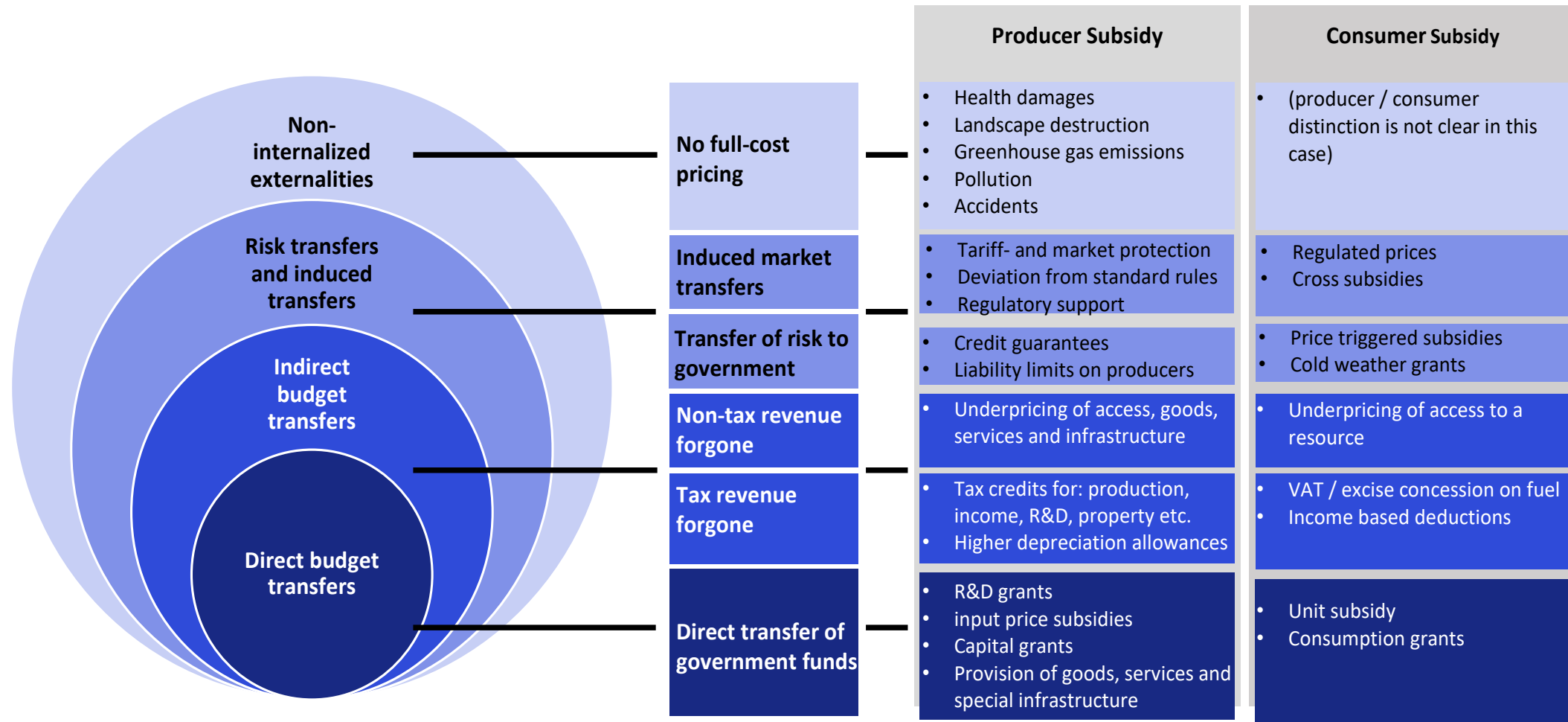
Step 1: Draw up a subsidy inventory



- Subsidy definitions
- Possible approaches
- Towards more comprehensive inventories
- Accessing international support
 - => The SDG12 Hub
 - => The APEC Peer Review Process
- Examples from Germany and Italy



Step 1: A typology of fossil fuel subsidies



Source: Adolf et al. 2014



Step 2: Analyse how the underlying mechanisms of fossil fuel subsidies influence prices

The four dimensions of fossil fuel pricing

FF price regulation

1. What mechanisms are in place to influence FF prices?
2. Do they limit pass-through of price fluctuations to consumers?
3. How do they work?

Level of subsidies / taxation

1. How much do FFS reduce the end price of FF?
2. Where is their incidence in the supply chain?
3. How and to what extent are FF taxed?

Transparency

To what extent is the composition and regulation of energy prices open and transparent?

Enforcement

To what degree is energy pricing monitored, supervised, and enforced?



Step 2: Analyse how the underlying mechanisms of fossil fuel subsidies influence prices

Understand how FFS affect the wider economy, environment and society

1. Identify subsidy beneficiaries.
2. Understand original rationale for FFS, ascertain whether it is still fulfilled
3. Are these aims still desirable?
4. Analyse subsidy incidence, i.e. the aspect of production or consumption to which the subsidy is targeted.
5. Tools to understand distribution of subsidy benefits across income groups:
 - => Commitment to Equity Institute
 - => IMF tool for distributional incidence analysis



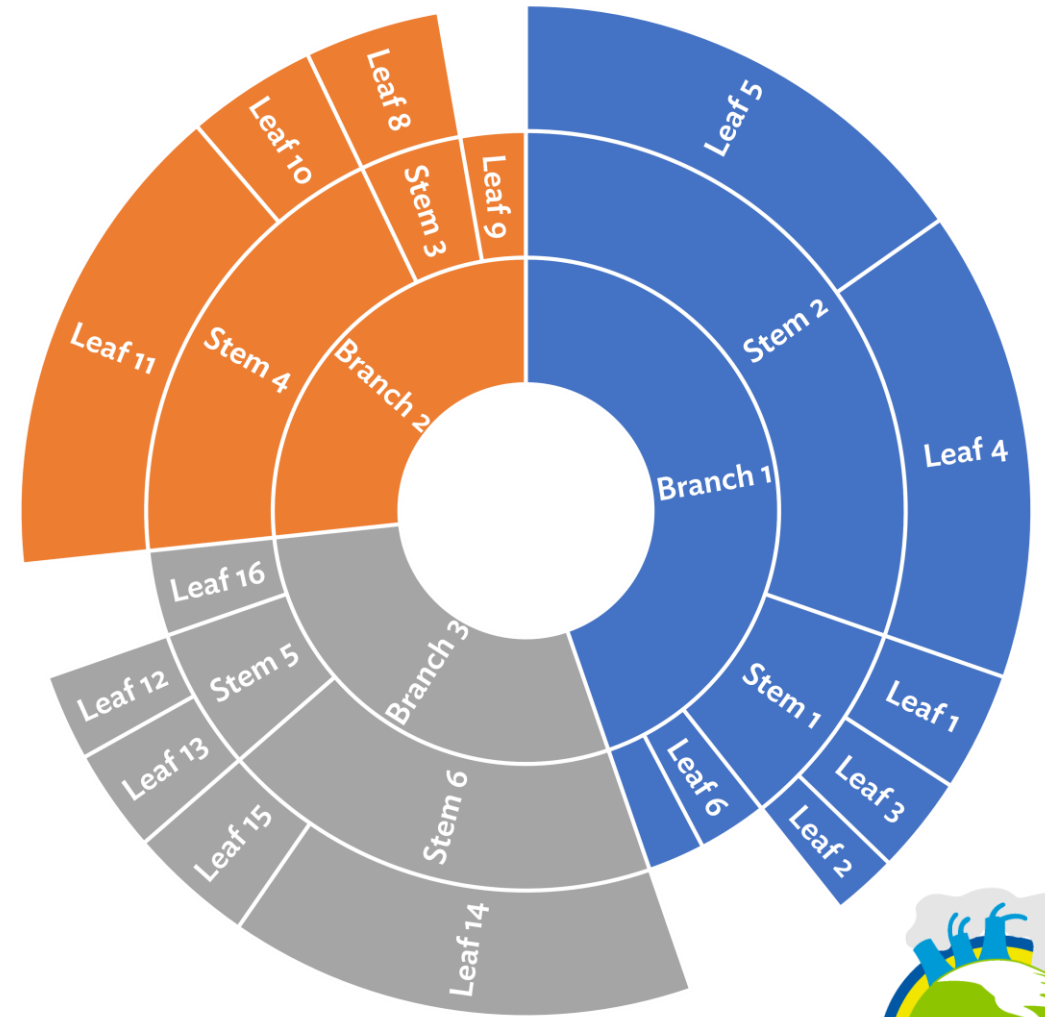
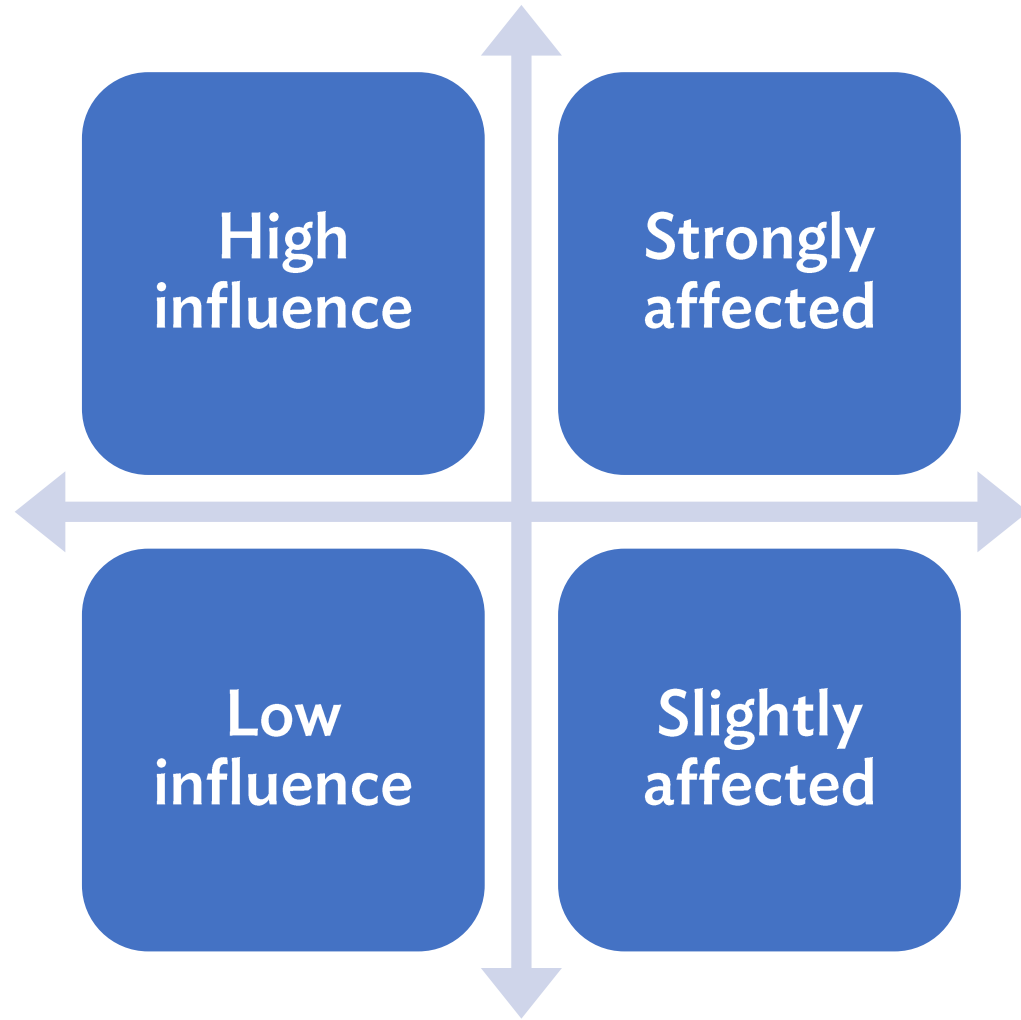
Step 3: Predicting impacts of FFSR: tools for the

Possible tools to inform efforts to predict the impacts of rationalization

Qualitative	Quantitative	Stakeholder engagement
Checklists of common impacts	Input-output tables	Interviews with key stakeholders
Literature review and historical analysis	Social Accounting Matrices (SAM)	Public consultation processes
Prioritise vulnerable groups dependent on subsidies	Micro-simulation models and Computable General Equilibrium (CGE) models	Focus groups, roadshows, workshops



Step 3: Predicting impacts of FFSR: tools for the analysis

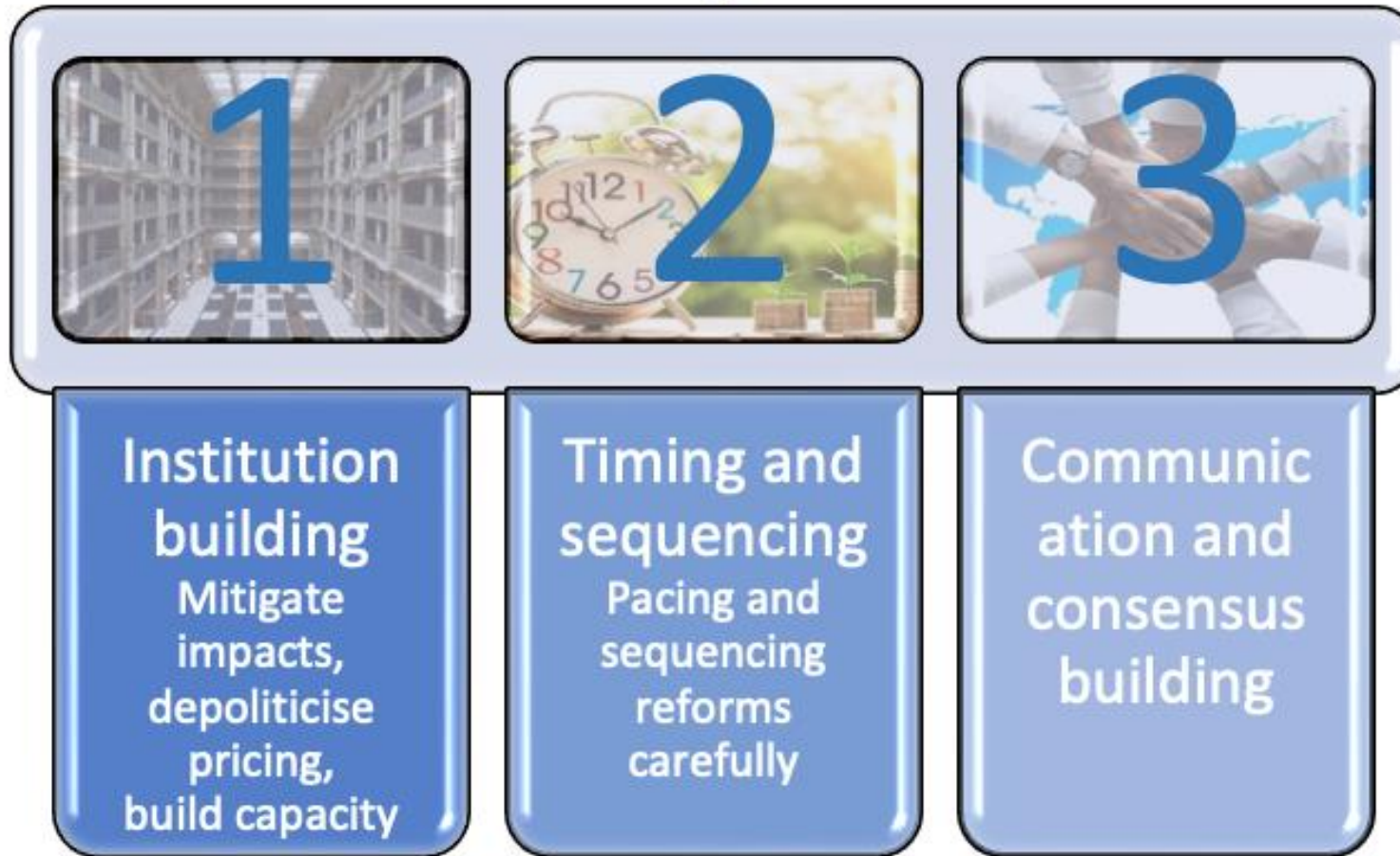


Step 4: Drawing up a priority list for FFSR

- **Estimated cost:** what is the burden of the subsidy on the budget?
- **Distortiveness:** impacts on economic decision-making, i.a. prices, consumption, production...
- **Environmental harmfulness:** impacts on climate, air, water and soil quality, biodiversity?
- **Social impacts:** health costs, equity implications of FFS and FFSR, welfare?
- **Effectiveness and subsidy incidence:** does the subsidy meet its objectives? Could the same objective be achieved in a less environmentally harmful way?
- **Mitigation of impacts:** which impacts can and should be mitigated?
- **Political economy:** How might it be possible to build consensus and achieve political acceptance for the rationalization of specific subsidies?
- For the sections on environmental and social impacts, DMC governments can draw on national statistics and [IMF data on post-tax subsidies](#).

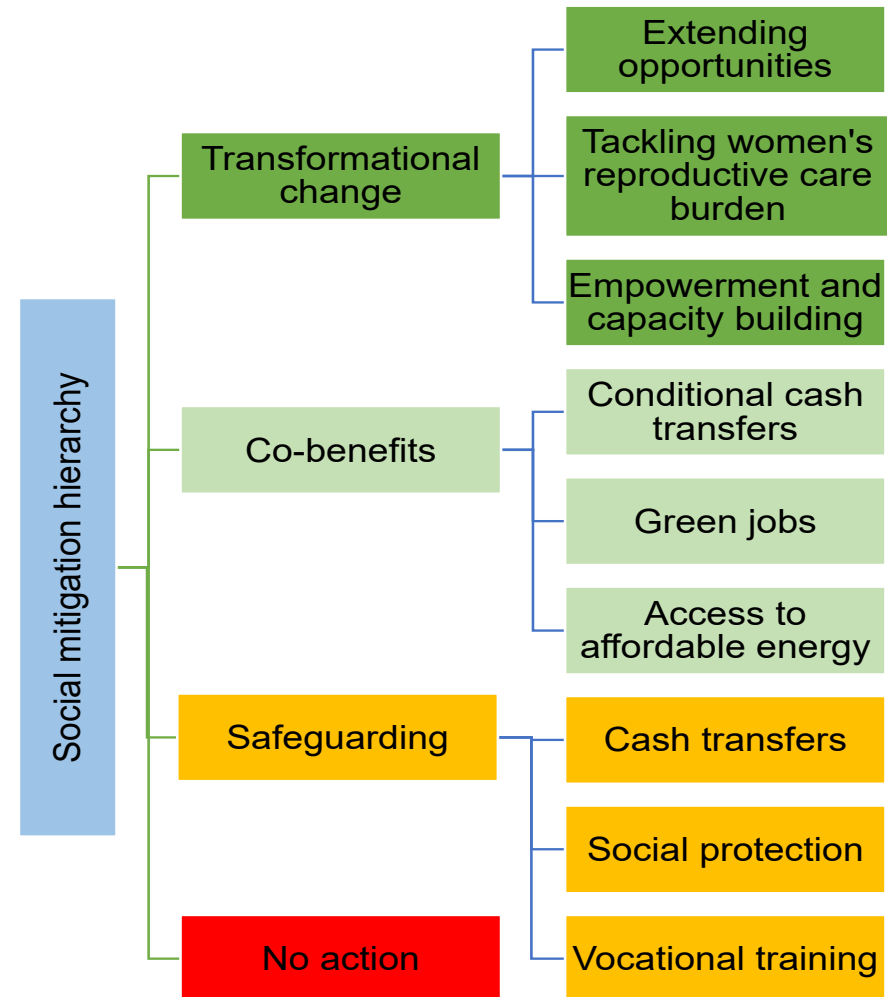


Step 5: Strategic design



Step 5: Institution building

1. **Depoliticise** fossil fuel pricing
2. Develop mechanisms for **distribution of targeted welfare**
3. Design **support measures** for industry
4. **Build capacity and consensus** within government



Step 5: Timing and Sequencing

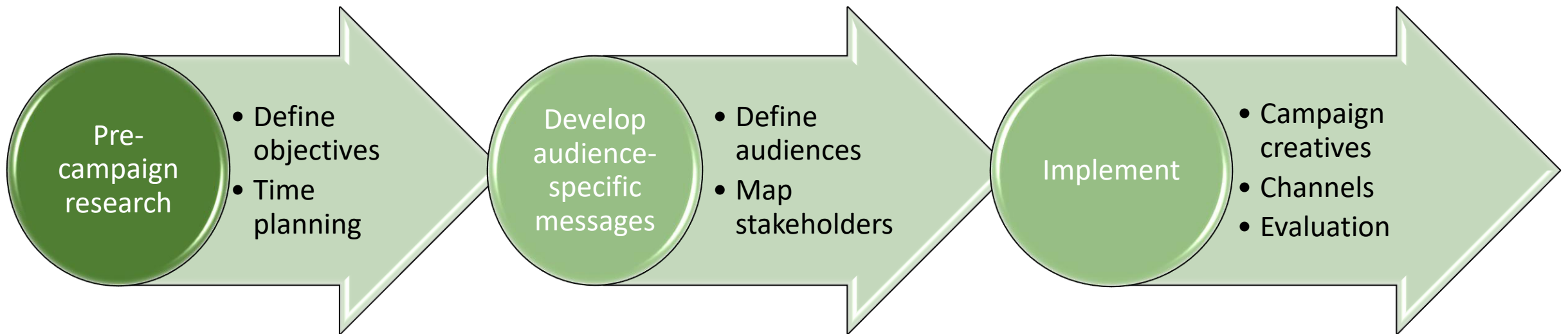
1. **Pacing reform:** big bang vs. gradual approaches
2. **Strategic timing**
3. **Sequencing reform**
4. The case of Iran



Step 5: Communication and consensus building

- Communication campaigns and stakeholder engagement are key strategies to build consensus

Idealised model of the development of a communications campaign



Source: author, Bridle et al. 2013



Step 6: Monitoring and adjustment

How have stakeholders actually been affected?

Has rationalization been effective?

- Unwanted substitutions
- Smuggling
- Fuel adulteration
- Negative equity impacts
- Impacts on industrial sectors
- Inflation



Concluding words

- FFSR is a challenging and **politically sensitive process**.
- Rationalization calls for both **political will** and **in-depth understanding** of the political economy of FFS and their reform.
- Many countries **subsidize fossil fuels while also introducing carbon pricing**, including OECD countries.
- To achieve the **Agenda 2030**, all countries must rationalize ‘inefficient’ FFS, cf. SDG 12.
- FFSR is also essential to achieve the targets of countries’ Nationally Determined Contributions under the **2015 Paris Climate Agreement**.
- DMC governments will need to **explore which carbon pricing approaches are most likely to be workable, effective and politically feasible** in their specific country context.



Thank you for your attention.
I look forward to your questions.

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