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PROGRAMME FOR CENTRAL AND EASTERN EUROPE, CAUCASUS AND CENTRAL ASIA

SUMMARY RECORD
of the Expert Meeting on Launching Work on Environmentally-Harmful Subsidies in Eastern Europe,
Caucasus and Central Asia

30 March 2012, Paris, France

A draft version of this document was circulated to meeting participants for endorsement through a written procedure. The attached document is the final summary record of the expert meeting held on 30 March 2012.

ACTION REQUIRED: For information.

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**EXPERT MEETING ON LAUNCHING WORK ON ENVIRONMENTALLY-HARMFUL
SUBSIDIES IN EASTERN EUROPE, CAUCASUS AND CENTRAL ASIA**

30 March 2012, OECD Headquarters, Paris

SUMMARY RECORD

Introduction

An expert meeting on environmentally-harmful subsidies (EHS), with a focus on the energy sector and climate change, was organised on 30 March 2012 under the auspices of the OECD Task Force for the Implementation of the Environmental Action Programme (EAP Task Force) for Eastern Europe, Caucasus and Central Asia (EECCA¹) countries. The meeting was attended by 20 participants, including experts from both OECD and non-OECD countries, as well as by OECD and IEA staff members working on related issues (for more information, see the List of Participants attached below).

The main objectives of the meeting were to:

- review the experience with applying existing tools and models for identifying, quantifying and assessing environmentally-harmful subsidies and modelling the impact of subsidy phase-out on greenhouse gas emission (GHG) reductions;
- identify challenges to their practical application at a country and sector level; and,
- brainstorm and identify potential areas for further development of these tools in adapting them to the energy sector and to the level of an individual EECCA country.

In support to the discussion, the EAP Task Force Secretariat prepared a thematic overview paper.

The meeting started with a brief introduction of the EAP Task Force's project on EHS, in particular energy subsidies and climate change, by Mr Brendan Gillespie (OECD Environment Directorate) and Ms Nelly Petkova (OECD Environment Directorate). It was stressed that this work will focus specifically on fossil fuel subsidies and potentially electricity and heat subsidies. Nuclear and bio-fuel subsidies would be excluded from the analysis as very few countries in the region have developed these energy sources.

Review of the experience with using various tools for EHS identification, quantification and assessment

After a brief introduction of some of the main challenges related to the classification of subsidies and the lack of universally accepted subsidy definition (Nelly Petkova), the discussion focused on various tools and approaches for EHS identification, estimation and assessment and the experience of different countries with the application of these tools. The main tools covered during the meeting included: the OECD quick scan, checklist and integrated assessment, the Consumer Subsidy Estimate (CSE) and the Producer Subsidy Estimate (PSE) as well as the IEA price-gap approach. The application of these tools in selected OECD and EU member states as well as in the Russian Federation was discussed in more detail in different presentations.

¹ The EECCA countries include: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, the Russian Federation, Ukraine, Uzbekistan, Tajikistan and Turkmenistan. The EAP Task Force is a regional programme that provides support to the 12 EECCA countries to reform their environmental policies and institutions. The current programme of work has two main areas: reforms to support green growth development and water resource management in the EECCA countries.

Mr Patrick ten Brink (Institute for European Environmental Policy) presented the results of a *survey on EHS conducted at the EU level* and the use of the OECD quick scan, checklist and integrated assessment tools in this context. The conclusion from this work is that these tools can be used for effective initial screening and identification of different subsidy schemes. In general, the OECD tools are good to document various subsidy measures and as such can help increase their transparency. These tools however can give the impression that they are very much focused on the environmental effects of a subsidy scheme. To mitigate this effect and particularly to support a discussion on the reforms of significant subsidy measures further in-depth analysis may be needed in order to model also the economic and social impacts of subsidy phase-out. However, general equilibrium models, which support such analysis, usually require a lot of expenditure and income data (e.g. to calculate price elasticities) which are not easily available to policy makers.

Mr Ronald Steenblik (OECD Trade and Environment Directorate) presented some of the *major lessons learnt from the work on measuring support to fossil fuels (using CSE/PSE) in selected OECD countries* provided through both direct budgetary transfers and tax expenditure. Mr Steenblik underlined a series of challenges related to subsidy definition and measurement, particularly in the context of subsidy reporting and reform commitments by the G-20 members:

- If direct budget support is easier to identify and measure, tax expenditure are more elusive. The main challenge in assessing tax expenditure is to identify the benchmark tax regime against which the extent of any tax deviation will be judged. Including subsidies at the sub-national level complicates further the picture.
- While market price support has largely disappeared from energy subsidies in the OECD countries, the magnitude of such support can be obtained by examining import tariffs on fossil-fuels.
- Because of this national reference benchmarking (where tax expenditure are taken relative to a tax system of a country) and due to the lack of a universal framework to monitor and report on subsidies, it is difficult to compare totals across countries in a meaningful way. As a result, caution is needed in interpreting and aggregating data.

If until recently the focus of analysis in non-OECD countries was mostly on energy consumption subsidies, some countries have also started studying subsidies disbursed to producers, as exemplified by the presentation of Ms Ivetta Gerasimchuk (Global Subsidies Initiative (GSI), International Institute for Sustainable Development). Ms Gerasimchuk presented some of the major lessons learnt from *identifying and quantifying fossil fuel producer subsidies in Russia* and the challenges related to subsidy definition and evaluation. Despite the lack of a universal definition, the World Trade Organisation (WTO) definition (based on the Agreement on Subsidies and Countervailing Measures), legally accepted by the WTO member countries, is used in the methodology applied by the GSI in their studies. This methodology is largely compatible with the OECD methodology for fossil fuel subsidies. Similarly to OECD, GSI has faced challenges in measuring the subsidies and in determining the benchmark.

The price-gap, the most commonly applied methodology for quantifying consumption subsidies, was at the focus of the presentation of Mr Jung Woo Lee (International Energy Agency). The IEA estimates *subsidies to fossil fuels that are consumed directly by end-users or consumed as inputs to electricity generation*. It compares average end-user prices paid by consumers with reference prices that correspond to the full cost of supply. The price gap is the amount by which an end-use price falls short of the reference price and its existence indicates the presence of a subsidy. The IEA database on subsidies contains estimates for 37 emerging and developing countries (in 2009).

The price gap is a relatively simple method that allows comparability and in addition can be used to feed other global macroeconomic models. At the same time, this method has a number of limitations, particularly related to the type of data and assumptions needed for accurate price-gap measurements, that is world reference prices. Besides, the price-gap does not capture such subsidies, as production subsidies, rebates to consumers, the effect of cross-subsidies, the cost of investing in new capacity (electricity). However, the ability of this method to quantify important pricing distortions quickly across countries is important even if the results are not perfect. In addition, the IEA has designed a model that provides medium to long-term energy projections (the World Energy Model used by the IEA in producing the World Energy Outlook). This model also quantifies the economic and environmental gains from reducing fossil fuel consumption subsidies. It was agreed that the IEA will provide the model methodology that will be then circulated to all meeting participants.

Modelling the linkages between inefficient energy subsidies and greenhouse-gas emissions

Mr Jean Chateau (OECD Environment Directorate) presented the OECD work on *modelling the impact of fossil fuel subsidy removal on GHG emissions using the OECD ENV-Linkages model*. This is a worldwide multi-sectoral, multi-regional computable General Equilibrium Model. As such, the model describes how households and firms interact with each other on different markets and provides a description of the entire economy. The model looks at various policy instruments, such as: market-based instruments for climate change mitigation (emission trading schemes, carbon taxes), fiscal instruments (household taxes, subsidies on production factors to producers, excise taxes on product sales by agents, tariffs and export taxes, government spending). In terms of sectoral aggregation, the model has: 5 agriculture related sectors, 4 primary energy related sectors (crude oil, coal, gas, petroleum refineries), 7 electricity related technologies /sectors (fossil fuels without carbon capture and storage (CCS), coal with CCS, gas with CCS, hydro/geothermal, nuclear, solar/wind, biomass/waste), 6 energy intensive industries (non-ferrous metals, iron and steel, chemicals, fabricated metal products, paper and paper products, non-metallic minerals), and 6 other sectors.

The model makes use of the IEA database on subsidies. In reality, climate change impacts are not assessed, the model assesses the costs but not the benefits of various climate-related policies. The use of the IEA subsidy database (based on the price-gap method) implies some uncertainty with regard to energy prices, in terms of energy demand/supply responsiveness. To correct for such errors, the data in the model are tested by using also other data sources.

Apart from Russia, the EECCA countries are aggregated under the “rest of the world” region and, as such, it is rather difficult to unbundle them and model GHG emission reductions as a result of subsidy phase-out in one individual country.

The last presentation was made by Mr Rafal Stanek (SST-Consult, Poland) who summarised the *advantages of and challenges to using the different methods for EHS identification, measurement and assessment* presented earlier in the discussion. The main conclusion is that each approach/model has been prepared for a specific purpose and can be useful in assessing different aspects of a subsidy measure. Mr Stanek also discussed a possible procedure for launching the work on EHS in the EECCA countries and how the different methods can be used and complement each other. It is obvious that more thinking needs to be put into this work particularly with regard to modelling the impact of the subsidy phase out on GHG emission levels.

Conclusions

The main conclusion is that despite existing challenges with subsidy definition, measurement and evaluation, subsidy tracking in the EECCA countries can proceed even with remaining areas of definitional disagreement. Other key conclusions include the following:

- ***A mix of analytical tools is needed to properly guide policy analysis and reform of subsidies.*** Identification and valuation need to be separated from assessing social or environmental impacts of a subsidy programme. It is obvious that there is a need to combine the bottom-up and top-down approaches: a type of price-gap or CSE/PSE approach to quantify the size of the subsidy and policy advice. At a country level, there is a need to identify a sub-sector based on the potential impact of the phase-out of existing subsidy schemes. As no model is perfect, whichever model we choose to use for the analysis, we need to understand its limitations and clearly spell out what the model can and cannot do.
- ***The complexity of subsidy programmes is an important impediment to improved transparency in reporting and valuation of subsidies, disbursed at a national, but also regional and local, level.*** Achieving transparency is complicated by the existence of many mechanisms for value transfer, ranging from direct spending programmes to more opaque instruments (such as special tax rules, credit subsidies and liability caps) as well as the large number of institutions involved in providing subsidy support including, among others, ministries responsible for resource extraction, taxation, energy, environment, commerce. In addition, the complexity of subsidy measures is often rooted in the multiplicity (and sometimes incompatibility) of policy objectives that such schemes are designed to achieve. Also, the reform process will generally depend on the availability of other policy tools in a country for achieving a specific policy goal. All this makes the assessment of subsidy effectiveness even more difficult.
- ***Evaluating subsidy effectiveness and efficiency is yet another problem.*** There are different evaluation approaches, including, macro modelling (through a general equilibrium model), micro modelling (calculating the Net Present Value of the subsidy level) or “soft” evaluation. Each of these approaches has its advantages and disadvantages but they are generally time and resource-consuming. Macro modelling often suffers from this same criticism based on the “no ideal definition – no ideal measurement – no ideal modelling” state of affairs. The “soft” evaluation approach, on the other hand, can be used to encourage public debate on EHS reforms through the provision of systematised information on the existence and size of such subsidies.
- ***Modelling of the impact of the phase out of fossil fuel subsidies, regardless of their nature, makes sense at a national level only if the model is recognised by national experts in the government.*** If this is not the case, the model risks to remain an academic exercise, not accounting for the specifics of the local context. Evidence shows that existing economic models in the EECCA countries are often based on shaky local data, disregarding the share of grey economy, energy leakages and actual social stratification. In addition, price elasticity of demand for energy also requires much more research, as price elasticities depend on the individual country and on the model.
- ***Using public domain data makes the outcomes of analysis less controversial.*** In terms of potential sources of information, official materials of fiscal planning, such as national budget laws, reports on budget execution, clarification notes prepared by the Ministry of Finance as part of the budget drafting process, materials of the budget committees, tax expenditure reports (that cover, for example, corporate and personal income taxes, VAT, excise taxes), Tax Policy Guidelines, Tariff and Customs Policy Guidelines could be used. Other sources can include: official subsidy monitoring reports of the Accounting Chamber, academic papers, media reports. Where appropriate, production-sharing agreements may also be worth looking at. As data will be often disaggregated, there is a need for discussion and close communication with experts from the government.

- ***In talking to policy makers it is important to stress the benefits and opportunities from subsidy reforms rather than the negative effects from their phase-out.*** The existence of alternative benign technologies is crucial in order to persuade policy-makers and the public to engage in subsidy reforms. There is no point to waste “political capital” in areas where benign alternatives are not viable.
- ***The political economy of subsidy support is as important as the technical analysis of EHS schemes.*** It is worth investing in the politics of fossil fuel subsidies, particularly if the government is willing to cooperate.

It was agreed that the draft overview report will be completed, taking into account comments and suggestions made during the meeting and circulated back to participants for their final review. In addition, the IEA kindly agreed to make their model methodology for quantifying economic and environmental gains from reducing fossil fuel consumption subsidies available to meeting participants.

Annex I: Agenda

Friday, 30 March 2012

Session 1	Welcoming remarks and adoption of the agenda
9:30	<ul style="list-style-type: none"> • <i>Brendan Gillespie, OECD, ENV/EPI</i>
Session 2	Introduction of the project on Energy subsidies and climate change in the countries in Eastern Europe, Caucasus and Central Asia
9:50	<ul style="list-style-type: none"> • <i>Nelly Petkova, OECD, ENV/EPI</i>
Session 3	Review of the experience with applying in practice the various OECD tools for EHS identification and estimation
10:10	<ul style="list-style-type: none"> • Challenges to the definitions and classification of subsidies; types of energy subsidies — <i>Nelly Petkova, OECD, ENV/EPI</i> • Lessons learnt from the use and application of OECD tools — quick scan, the checklist and the integrated assessment tool — in the EU member states. The EU “recipe book” for identification and assessment of subsidies and development of EHS reform road maps — <i>Patrick ten Brink, IEEP</i> • Lessons learnt from the work on fossil fuel subsidies in the OECD countries — <i>Ronald Steenblik, OECD, TAD/EP</i> • Lessons learnt by the Global Subsidies Initiative from identifying and quantifying energy producer subsidies in Russia and other countries — <i>Ivetta Gerasimchuk, Global Subsidies Initiative</i>
12:30	Lunch break
Session 4	Modelling the linkages between the size of inefficient energy subsidies and greenhouse-gas emissions
14:00	<ul style="list-style-type: none"> • Price-gap methodology for estimating energy subsidies and experience with its application at a country level — <i>Jung Woo Lee, IEA</i> • ENV-LINKAGES model: Experience with its development and use and opportunities for applying it at a country level — <i>Jean Chateau, OECD, ENV/CBD</i> • Proposal for potential elements of a model focused on energy sector-related subsidies and their linkages to greenhouse gas emissions — <i>Rafal Stanek, Consultant, Poland</i>
Session 5	Closing session — Next steps in project implementation
16:30	<ul style="list-style-type: none"> • Discussion of the additionally needed modelling work and how to best implement it • Next steps in advancing the project • Closure and wrap-up of the meeting

Annex II. List of participants

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