

Fossil-fuel subsidies in the EU's Eastern Partner countries

How governments supported fossil fuels in 2020

ARMENIA | AZERBAIJAN | BELARUS | GEORGIA | REPUBLIC OF MOLDOVA | UKRAINE

POLICY HIGHLIGHTS

Background

Governments have long relied on fossil-fuel subsidies to advance specific development goals or to address what might have been perceived as market failures. The most common argument for introducing and maintaining such subsidies is that they support important domestic policy objectives, such as rural and industrial development, improved energy access, energy security and independence, and poverty alleviation.

However, analysis has shown that fossil-fuel subsidies are economically inefficient, environmentally harmful, fiscally costly and not particularly equitable. Due to their social impact, reforming such subsidies also meets with a lot of resistance.

Phasing out fossil-fuel subsidies is one of the main elements of the policy toolbox aimed at combating climate change. Investing time and resources to identify and measure fossil-fuel subsidies and the potential distributional effects of their reform and phase out can help policy makers make better informed decisions when they need to reform subsidies. Analysis can also help identify their impacts to all stakeholders, especially to those segments of the population that may be most negatively affected by the reform.

In order to help governments in the EU's Eastern Partner (EaP) countries (Armenia, Azerbaijan, Belarus, Georgia, Republic of Moldova (hereafter "Moldova") and Ukraine) develop a better understanding of existing fossil-fuel subsidy schemes and their economic, social and environmental impacts, the Organisation for Economic Co-operation and Development (OECD) conducts regular data collection and analysis of such government support.

In 2018, the OECD prepared an "Inventory of Energy Subsidies in the EU's Eastern Partnership Countries". Funded by the European Union, this study was the first comprehensive and consistent record of energy subsidies in the region and was developed with a view of improving transparency and establishing a solid analytical basis that can help build the case for reforms in the EaP countries. Based on the OECD standard methodology, the study provided quantitative estimates of government support channelled to consumers and producers of coal, oil and related petroleum products (particularly in the transport sector), natural gas, and



electricity and heat generated on the basis of these fossil fuels. The estimates covered the period 2010-15.

In 2021, within the "European Union for Environment" programme, the OECD prepared a new round of analysis published in the report on "Fossil-Fuel Subsidies in the EU's Eastern Partner Countries: Estimates and Recent Policy Developments". The 2021 report measures subsidies available over the period 2016-19. The report focuses on two major groups of subsidies: (i) direct transfers of funds to producers and consumers of fossil fuels, and (ii) tax expenditure and other government revenue foregone resulting from deviations from a benchmark tax treatment.

The data from these analyses are now available in the OECD database on government support to fossil-fuel production and consumption. The inclusion of the EaP countries in this database is an important milestone in achieving transparency, made possible due to their cooperation with the European Union. It recognises efforts of the EaP governments to disclose information on government support volumes that go to the energy sector in these countries.

These Policy Highlights summarise the main findings of additional analysis carried out by the OECD in late 2021 to identify fossil-fuel support measures that the EaP governments put in place in 2020 when the COVID-19 pandemic hit the world. For this reason, there is particular focus on comparing 2020 subsidisation levels with the trends in the 2019 pre-pandemic year.



Fossil-fuel subsidies in the EaP countries increased by more than 6% in 2020 compared to 2019

The amounts of fossil-fuel subsidies in the EaP countries fluctuated during the period 2010-2020. Since their peak in 2012 when they amounted to more than USD 5 billion they have significantly decreased and dropped to less than USD 2 billion in 2015. However, in 2016 subsidies started growing again and since then they have generally stabilised around +/- USD 3 billion. This general decline in subsidisation levels in the period 2015-19 was due to the phase out of a number of subsidy schemes in Armenia, Belarus and particularly in Ukraine.

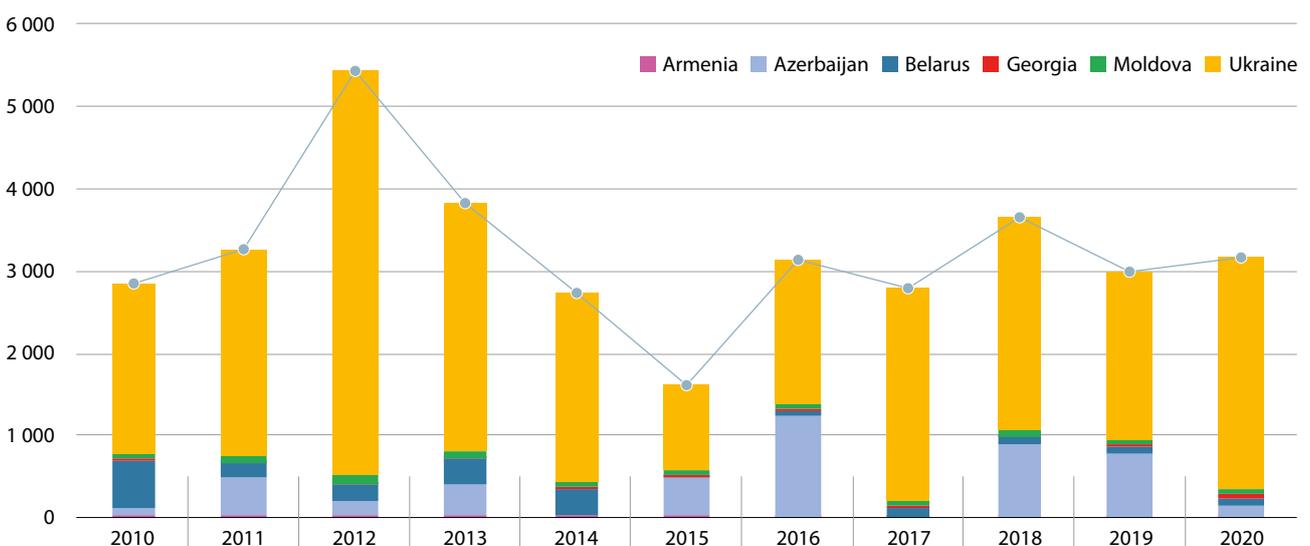
The COVID-19 crisis that hit in 2020 made the EaP countries painfully aware of the need to mobilise significant additional funds to support their health systems and economies. Despite low energy prices and reduced economic activity, total government support

(direct budgetary flows and tax expenditure) provided to producers and consumers of fossil fuels in the EaP region actually increased in 2020 compared to the 2019 level.

While the EaP countries spent about USD 3 billion on fossil-fuel support in 2019, this amount grew up to about USD 3.2 billion in 2020 resulting in an overall subsidy increase of more than 6%. The increase was driven by spending in Ukraine (USD 2.8 billion in 2020 or 89% of total regional support). Armenia and Georgia saw a significant surge in government support to fossil fuels in 2020 compared to 2019 which translated into an approximately 170% increase for Armenia and 480% for Georgia. This increase was largely attributed to newly-introduced COVID-19 related fossil-fuel measures to compensate households' natural gas and electricity bills.

Table 1. **QUANTIFIED FOSSIL-FUEL SUBSIDIES IN EAP COUNTRIES, MILLION USD, 2010-2020**

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Armenia	28	37	41	42	42	32	22	22	5	4.6	12
Azerbaijan	90	469	180	372	0	458	1 214	0	897	787	151
Belarus	593.5	159.9	196.3	301.9	317.6	17.7	70.3	109.1	84.5	84.3	72.3
Georgia	7	7	8	11	11	10	8	9	9	9.3	54
Moldova	70	86	98	90	81	65	65	70	77	67.5	68
Ukraine	2 047	2 501	4 889	3 011	2 280	1 027	1 754	2 581	2 563	2 029.7	2 814



Note: Users of tax expenditure estimates should bear in mind that the Inventory records tax expenditures as estimates of revenue that is foregone due to a particular feature of the tax system that reduces or postpones tax relative to a jurisdiction's benchmark tax system, to the benefit of fossil fuels. Hence, (i) tax expenditure estimates could increase either because of greater concessions, relative to the benchmark tax treatment, or because of an increase in the benchmark itself; (ii) international comparison of tax expenditures could be misleading, due to country-specific benchmark tax treatments.

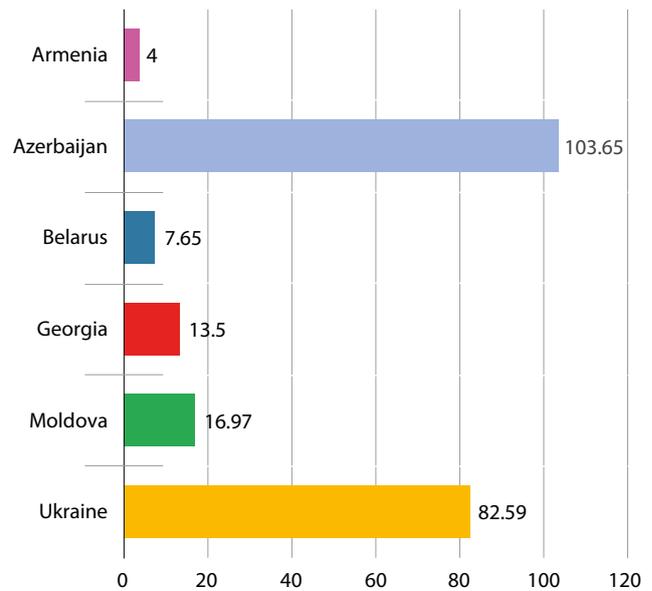
Source: OECD Fossil-Fuel Subsidies database, <https://www.oecd.org/fossil-fuels/data/>.

Azerbaijan and Ukraine had the highest level of support on a per capita basis in 2020

In relative terms, however, the picture is somewhat more nuanced. In 2020, on a per capita basis, with about USD 104, Azerbaijan came first followed by Ukraine where the per capita fossil-fuel government support stood at USD 83 whereas Armenia had the lowest support levels of USD 4 per capita in 2020.



Figure 1. PER CAPITA FOSSIL-FUEL SUBSIDIES IN EAP COUNTRIES, USD, 2020

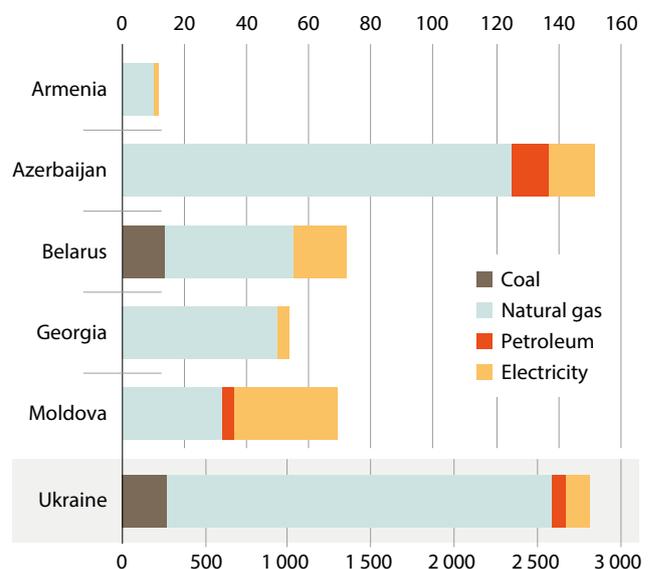


Source: <https://fossilfuelsubsidytracker.org/>.

Most subsidies targeted residential consumers and went to natural gas

Most subsidy measures supported the residential sector in the EaP countries in 2020 followed by support to the electricity generation sector with Armenia and Moldova providing no support to producers (or importers in the case of Armenia) of fossil fuels. Analysis of which fossil fuels benefited the most from government support in 2020 shows that the trend of previous years continued. A considerable share of support was allocated to natural gas (more than 80% of the total) and electricity while coal subsidies were significant in Ukraine only. Natural gas dominates the energy mix in these countries and is the main fuel used in generating electricity and heat in the region. The market of liquid petroleum products used in the transport sector is largely deregulated in most of the countries and these fuels get little government support.

Figure 2. QUANTIFIED FOSSIL-FUEL SUBSIDIES IN EAP COUNTRIES BY FUEL, MILLION USD, 2020



Source: OECD Fossil-Fuel Subsidies database, <https://www.oecd.org/fossil-fuels/data/>.



Analysis has shown that fossil-fuel subsidies are economically inefficient, environmentally harmful, fiscally costly and not particularly equitable.

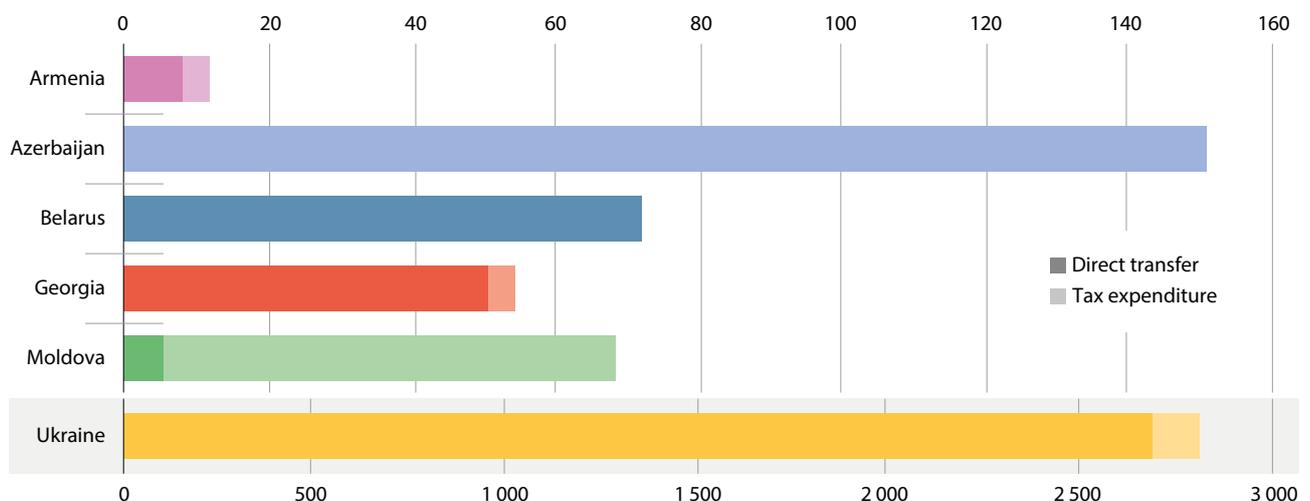


Most EaP countries used direct budgetary transfers to subsidise fossil fuels

Similarly to 2019, budgetary transfers prevailed in most EaP countries in 2020. In Moldova, tax expenditure was the main support mechanism.¹ It took the form of reduced value-added tax (VAT) rates for natural gas, electricity and heating to households and public institutions as well as for liquefied petroleum gas consumption. Tax expenditures were significant in Ukraine as well.

Unlike direct budgetary transfers which are relatively easy to identify and measure and are available from government budgetary planning and execution documents, tax expenditures are less straightforward and need additional effort to identify and estimate.

Figure 3. **QUANTIFIED FOSSIL-FUEL SUBSIDIES IN EAP COUNTRIES BY TYPE OF SUPPORT MECHANISM, MILLION USD, 2020**



Source: OECD Fossil-Fuel Subsidies database, <https://www.oecd.org/fossil-fuels/data/>.

1. Tax expenditure (and other revenue foregone) result from deviations from a benchmark tax treatment, such as reduction or exemption of excise taxes on fuel consumption, and are usually legislated through countries' Tax Codes. Given challenges with identifying the complete set of tax expenditure measures, it is possible that not all tax expenditure has been identified or fully quantified.

Fossil-fuel subsidies loomed large compared with the COVID-19 recovery packages put in place by EaP governments

In response to the COVID-19 crisis, the EaP governments sought to protect their citizens and businesses by putting in place rescue (short-term measures designed for emergency support to keep people and businesses alive) and recovery (longer-term measures to boost economic growth) packages. Most such measures in the energy sector have been largely concentrated in the end-use natural gas and electricity sectors. Most of the measures included assistance with covering bills or moratoria on disconnecting customers in arrears.

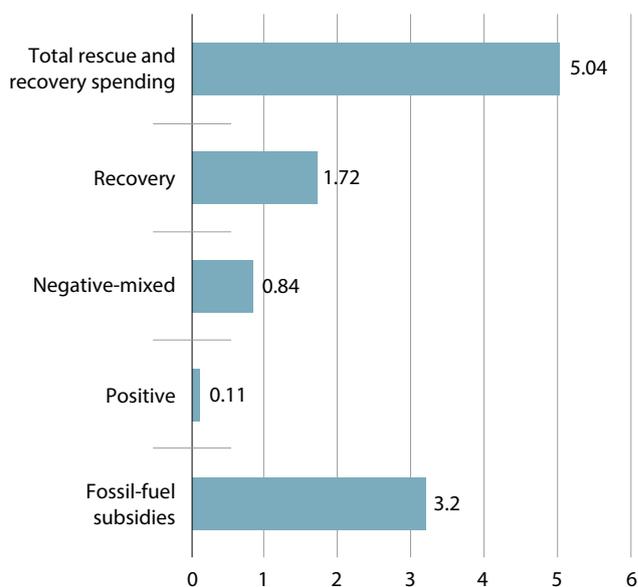
The OECD analysis, presented in the GREEN Action Task Force report on *Aligning Short-Term Recovery Measures with Longer-Term Climate and Environmental Objectives in Eastern Europe, Caucasus and Central Asia*, estimates that both rescue and recovery spending in the EaP countries totalled about USD 5 billion in 2020 and 2021 (data until end of October 2021) of which longer-term recovery support amounted to USD 1.72 billion.

Of the USD 1.72 billion in longer-term recovery spending only USD 0.11 billion is estimated to have positive environmental impact which pales in comparison to the USD 0.84 billion that was spent on measures that are estimated to have a mixed or negative impact on the environment. The analysis also shows that green recovery support is unevenly distributed with most of this spending made in Armenia and Georgia.



In comparison, the amount of government support that went to producers and consumers of fossil fuels in 2020 was USD 3.2 billion which is almost twice the government funding allocated to the long-term recovery packages mentioned above. With return to economic growth and with rising energy prices in the international markets, the International Energy Agency, in its *World Energy Outlook 2021*, expects that consumer fossil-fuel subsidies may more than double in 2021.

Figure 4. **RECOVERY PACKAGES (2020-21) VS FOSSIL-FUEL SUBSIDIES (2020) IN EAP COUNTRIES, BLN USD**



Source: OECD (2021a), [https://www.oecd.org/environment/outreach/ENVEPOCEAP\(2021\)4-GreenRecoveryEECCA.pdf](https://www.oecd.org/environment/outreach/ENVEPOCEAP(2021)4-GreenRecoveryEECCA.pdf).

Given the intensification of efforts to reach carbon neutrality across the world, fossil-fuel subsidies will be subjected to further and increased scrutiny. The staggering fact that fossil-fuel subsidies in 2020 alone exceeded the COVID-19 related recovery packages put in place in 2020 and 2021 points to the need of rethinking fossil-fuel subsidisation policies in the region.

In the backdrop of the COVID-19 pandemic and rising energy prices and as economies start to recover, the EaP governments should resist introducing new subsidy schemes or even turning them into a long-term structural feature of the economy which could bring vital economic, social and environmental benefits to the EaP economies and their citizens.



Further reading

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OECD/IEA (2021), *Update on Recent Progress in Reform of Inefficient Fossil-Fuel Subsidies that Encourage Wasteful Consumption*, OECD/IEA, Paris. <https://www.oecd.org/fossil-fuels/publicationsandfurtherreading/OECD-IEA-G20-Fossil-Fuel-Subsidies-Reform-Update-2021.pdf>.



These Policy Highlights present an update of the estimates of government support provided in 2020 to consumers and producers of coal, oil (and related petroleum products), and natural gas, as well as electricity and heat generated from these fossil-fuels in the six countries of the EU's Eastern Partner region – Armenia, Azerbaijan, Belarus, Georgia, Republic of Moldova and Ukraine. The analysis, based on the OECD standard subsidy estimation methodology and funded by the European Union, focuses on measuring two major types of fossil-fuel subsidies: direct transfers of funds to producers and consumers and tax expenditure. A particular focus of these Highlights is placed on analysing and comparing 2020 subsidisation levels with the trends in the pre-COVID pandemic year of 2019.

These Highlights, and the analysis presented here, have been developed as part of the work of the “European Union for Environment” programme (EU4Environment), which helps the six Eastern Partner countries of the EU preserve their natural capital and increase people’s environmental well-being.

The analysis in these Policy Highlights also makes part of the GREEN Action Task Force which is a unique platform for interested OECD and Eastern Europe, Caucasus and Central Asia (EECCA) countries as well as development co-operation partners that work together to help the EECCA countries develop policies that improve environmental quality and social well-being, while creating opportunities for strong economic growth and decent jobs.

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