

Making green fiscal reform happen: Overcoming obstacles and securing support

Sirini Withana

Senior Policy Analyst, Institute for European Environmental Policy (IEEP)

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The rise of the green fiscal reform (GFR) agenda

- Experience with GFR has grown over the past two decades.
- Attracted **increasing attention in recent years** driven by various economic/social/environmental factors, including:
 - Need for **fiscal consolidation** (e.g. Ireland, Italy, Portugal),
 - Recognition of **financial burden of certain measures** such as fossil fuel subsidies (e.g. India, Indonesia).
- Current context is **favourable for GFR** (e.g. decline in oil prices).
- **Numerous calls for action.**



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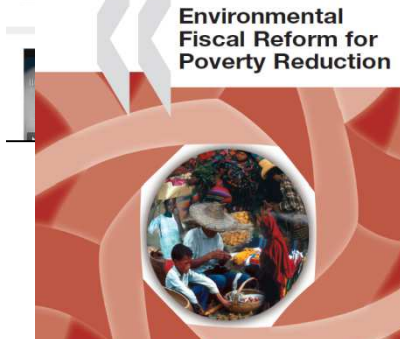
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GLOBAL INVESTOR STATEMENT ON CLIMATE CHANGE

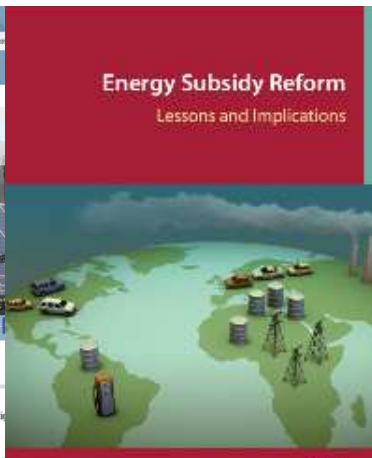
This statement is signed by 365 investors representing more than US\$100 trillion in assets under management.

We are particularly concerned that gaps, weaknesses and delays in climate change policies will increase the risks to our investments as a result of the physical impacts of climate change. We believe that well designed and implemented policies would significantly more in areas such as renewable energy, energy efficiency, sustainable development, thereby benefiting our clients and beneficiaries, and society as a whole.

There is a significant gap between the amount of capital that will be required to low carbon and climate resilient economy and the amount currently being invested. Investments in clean energy alone are approximately \$250 billion per year. The gap is estimated that limiting the increase in global temperature to two degrees Celsius requires average additional investments in clean energy of at least \$1.2 trillion per year.

his Statement sets out the contribution that we as investors can make to increase climate resilient investments. It offers practical proposals on how our contribution can be increased through appropriate government action.

Stronger political leadership and more ambitious policies are needed in order to achieve these goals. We believe that well designed and implemented policies would significantly more in areas such as renewable energy, energy efficiency, sustainable development, thereby benefiting our clients and beneficiaries, and society as a whole.



Energy Subsidy Reform
Lessons and Implications



A GUIDEBOOK TO FOSSIL-FUEL SUBSIDY REFORM
FOR POLICY-MAKERS IN SOUTHEAST ASIA
EXECUTIVE SUMMARY

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Environmental Fiscal Reform

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BETTER GROWTH
BETTER CLIMATE

The New Climate Economy Report
THE SYNTHESIS REPORT

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State and Trends
of Carbon Pricing

Washington DC
May 2014

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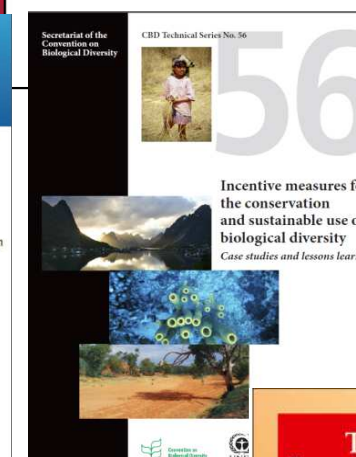
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Incentive measures for
the conservation
and sustainable use
of biological diversity

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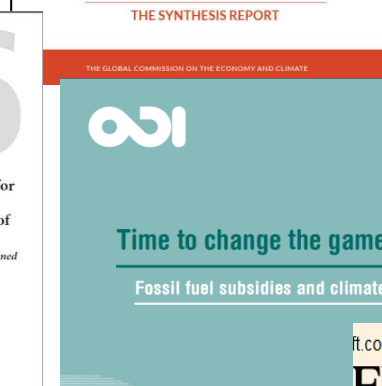
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Time to change the game

Fossil fuel subsidies and climate

Time to change the game

Time to change the game

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Time to change the game



GREEN economy

Driving a Green Economy
Through Public Finance and Fiscal Policy Reform

GREEN economy

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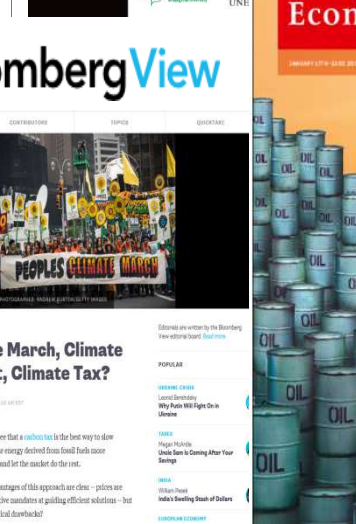
GREEN economy

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Bloomberg View



The Economist

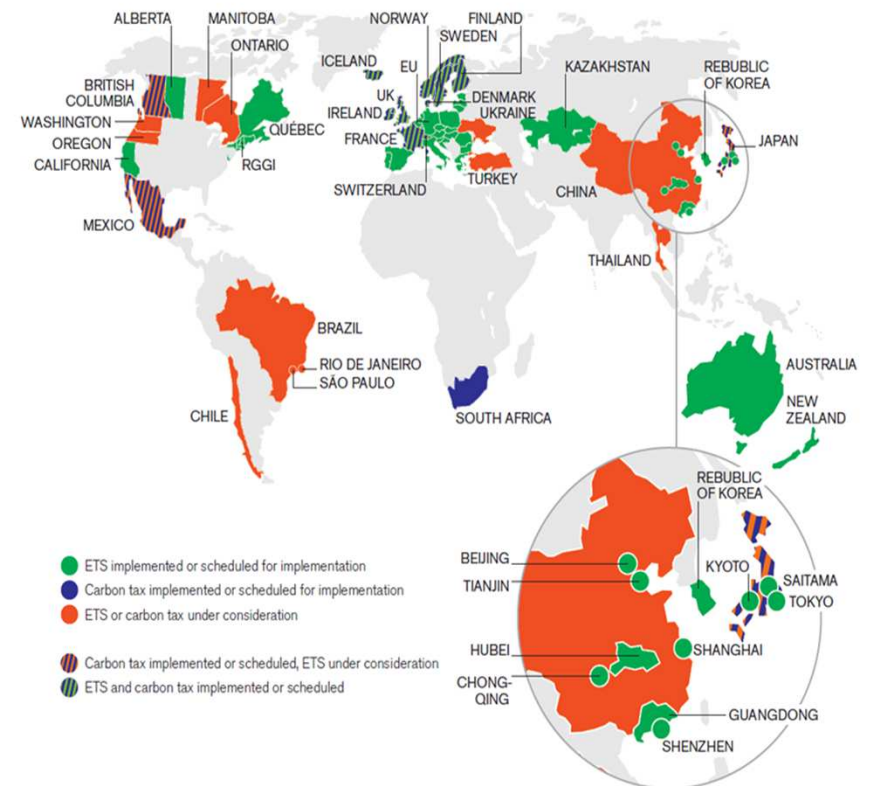


FINANCIAL TIMES

However, despite efforts GFR remains limited

- **88%** of annual global GHG emissions are **un-priced**.
- With due exceptions, many carbon pricing schemes:
 - Do not reflect environmental and social costs,
 - Are not well targeted, comprehensive or consistent in coverage.
- **Environmentally harmful and/or ineffective subsidies** remain significant in several sectors (e.g. agriculture, fisheries, energy etc.).

Figure 1: Overview of existing, emerging and proposed carbon pricing mechanisms



Source: World Bank, 2014

Action is often constrained by various obstacles

- Strength of **special interests** and **rent seeking behaviour**.
- Lack of **transparency, information and awareness**.
- **Administrative, institutional and technological** constraints.
- Lack of **political will** which often reflects **concerns of economic and social impacts** of reform, in particular on vulnerable groups.



While such concerns are important, they should not be an excuse to avoid / halt GFR as they can be addressed through careful design and implementation



Introduction to paper on 'Overcoming obstacles to GFR'

- Scoping paper commissioned by GGKP Fiscal Instruments Research Committee.
- Examines how obstacles to GFR can be overcome through:
 - Targeted **mitigation and compensation measures** for vulnerable firms/sectors and low-income households,
 - **Use of revenues** raised,
 - **Complementary strategies and tools.**
- Draws on lessons from **GFR experiences in developed and developing countries.**
- Focus on **environmental tax and subsidy reform across different sectors and areas.**

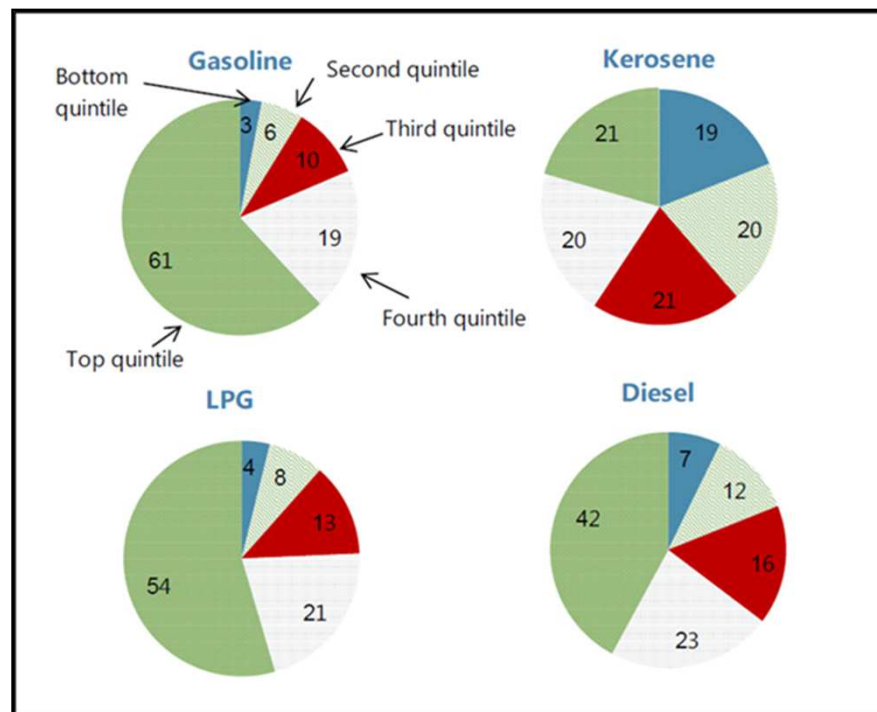
Potential impacts of GFR

- Impacts of GFR depend on **various factors**, can **vary over time** and **across different levels**.
- Use **quantitative and qualitative tools** to identify costs & benefits, winners & losers, intended & unintended effects across different spheres.
- Inform effective **design and implementation** of GFR process.
- Help **build support** among affected groups.

Unpacking the distributional effects of fossil fuel subsidies

- Proponents of fossil fuel subsidies often argue they are needed to protect poor households.
- However, such **subsidies benefit the rich more than the poor**, with impacts varying across fuel types.
- **Communicating** such inefficiencies can help build support for reform.

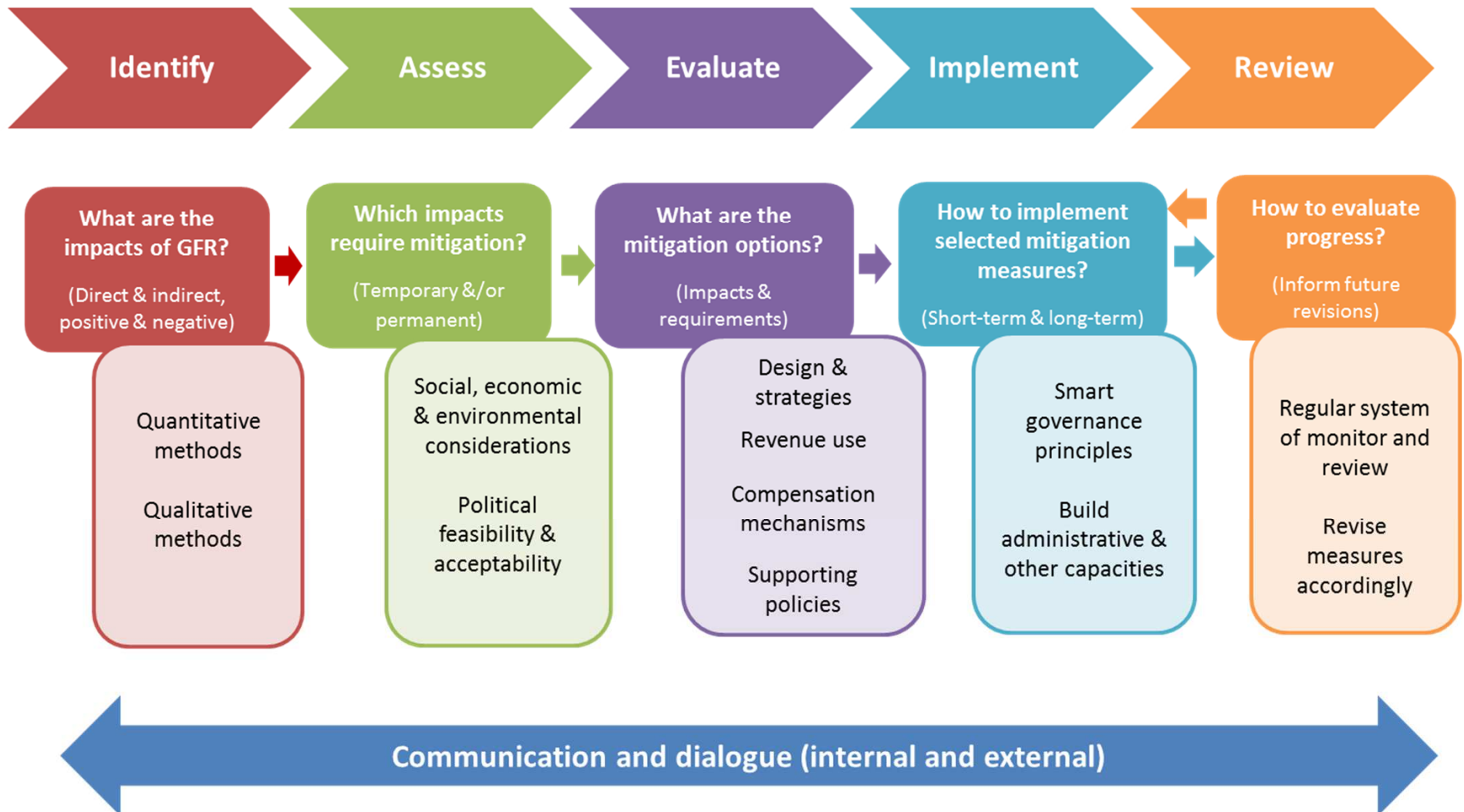
Figure 2: Distribution of subsidies to petroleum products by income group



Source: Arze del Granado et al. (2012) cited in IMF 2013

Some GFRs can also have regressive effects and wider impacts on vulnerable social/economic groups. Thus, GFR may require **targeted mitigation measures**.

Key steps in design and implementation of mitigation measures



Source: Own representation

Mitigating impacts through design and implementation

Type of measure	Strengths	Weaknesses
Timetable	<ul style="list-style-type: none"> - Pre-announced, phased introduction allows time to adjust - Provide certainty - Reduce opposition to reform - Time reform to minimise effects (e.g. low oil prices) 	<ul style="list-style-type: none"> - Could lead to backsliding & reversals of commitments - Risk of hoarding and shortages - Creates expectations of inflation - Foregone revenues (& environmental benefits)
Sequencing	<ul style="list-style-type: none"> - Temporary measure to reduce impacts on vulnerable groups - Pilot scheme / test provides opportunity for revision 	<ul style="list-style-type: none"> - Reduce revenues from GFR - Create distortions/negative incentives - Time for opposition to build up
Stakeholder engagement	<ul style="list-style-type: none"> - Build ownership & legitimise process - Increase awareness of objectives, pros & cons - Reduce opposition to reform 	<ul style="list-style-type: none"> - Risks delaying GFR process - Opportunity for lobbying against reform

Compensation measures for vulnerable firms/sectors

Type of measure	Strengths	Weaknesses
Reductions/ exemptions	<ul style="list-style-type: none"> - Reduce opposition & build support - Can encourage change & improve information asymmetry - Useful for political & public acceptability 	<ul style="list-style-type: none"> - Not efficient price signal/incentive - Could be over-generous - Advantages for certain firms and sectors, disadvantages to others - May be difficult to revise
Transitional assistance to affected workers	<ul style="list-style-type: none"> - Reduce opposition & build support - Link to wider complementary policies 	Could become entrenched in expectations of beneficiaries if not time limited
Incentives for innovation	<ul style="list-style-type: none"> - Facilitate transition in affected sector - Drive innovation - Reduce opposition & build support 	Could become entrenched in expectations of beneficiaries if not time limited
Cooperation between countries	<ul style="list-style-type: none"> - Avoid competitiveness concerns - Increase support - More effective & efficient instruments 	Difficult to get agreement on fiscal cooperation between countries, particularly large groupings
Border adjustments	<ul style="list-style-type: none"> - Avoid competitiveness concerns - Increase support for GFR - Encourage action by other countries - Reduce opposition & build support 	<ul style="list-style-type: none"> - WTO compliance - Could be administratively complicated - Political barriers

Compensation measures for vulnerable households

Type of measure	Strengths	Weaknesses
Cash transfers	<ul style="list-style-type: none"> - Give beneficiaries flexibility in spending - Link to conditionalities to ensure spent on 'desirable' uses (e.g. education) - Reduce opposition & build support 	<ul style="list-style-type: none"> - Requires administrative capacity & infrastructure (e.g. bank accounts) - Increase risk of corruption - Targeting errors - Requires regular monitoring - Could become entrenched in expectations
In-kind transfers	<ul style="list-style-type: none"> - Useful when lack capacity to implement cash transfers - Ease pressure on vulnerable groups - Political & public favour - Can include incentives to encourage behaviour change 	<ul style="list-style-type: none"> - Limited flexibility - Distort household choices - Could become entrenched in expectations of beneficiaries - Difficult to target, risk of diversion
Allowances / reductions	<ul style="list-style-type: none"> - Help protect low-income groups - Reduce opposition & build support - Ease of administration - Can provide incentives for conservation if well designed 	<ul style="list-style-type: none"> - Limited reach as only covers households connected to electricity grid/water - Undermine incentives for conservation - Risk of leakage if not well-targeted

Mitigating impacts through use of GFR revenues

- Options for revenue use:
 - Tax shift,
 - Raise revenues for general budget,
 - Recycle revenues into economy or affected sector,
 - Earmark revenues (full or partial),
 - Mix of approaches.
- Use of revenues and proportion spent on mitigation depends on **various factors** (objectives, sector/issue, impacts of reform & mitigation options, stakeholder perceptions, government credibility).
- Although some options may go against economic efficiency ideals, in certain cases they may be **pragmatic & politically useful**.
- Provisions need to be **well-designed** and **regularly reviewed**.

Smart principles for the design of mitigation measures

Target at most exposed or vulnerable groups.

Have a **clear timeline** including where relevant a schedule for progressive phase out.

Develop in an **open, participatory approach** with key stakeholders.

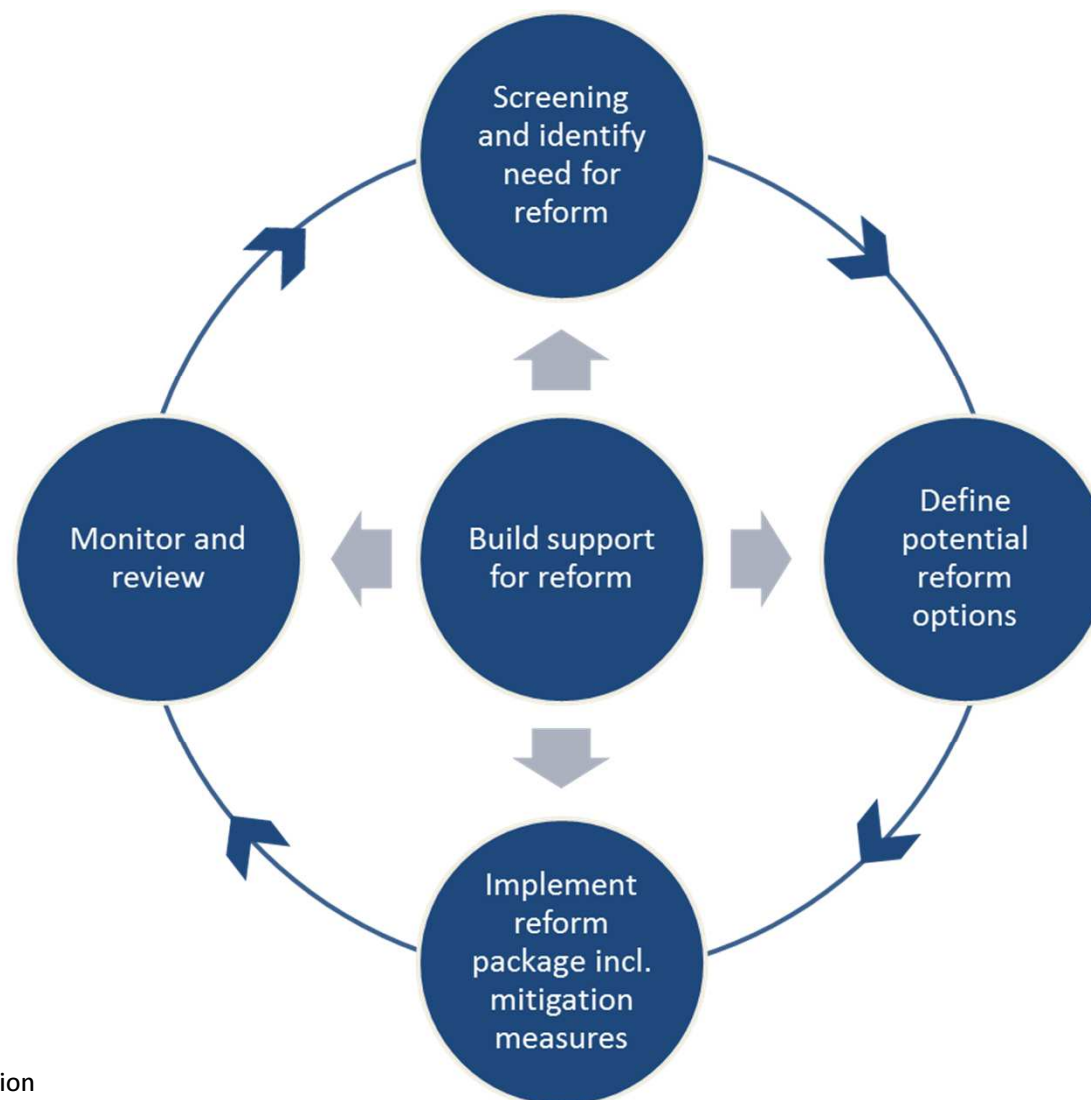
Simple to administer and build on existing systems and procedures to the extent possible.

Gradually reduce / phase out exemptions, use **partial reductions** and link to **effective conditionalities**.

Monitoring and review system, including review of revenues.

Strategies, approaches and tools to drive GFR

Figure 3: Stylised representation of GFR policy cycle



Source: Own representation

Processes, tools and wider context to support GFR

- **Identify needs for GFR** - assess status quo and options for reform.
- Make use of **existing tools and databases** (e.g. OECD, IMF, IEEP, GSI etc.).
- Establish **commissions or committees on (green) fiscal reform**.
- Present GFR as part of **wider package of reform** including compensation measures and complementary policies.
- Link GFR to **wider policy commitments & processes** (e.g. reduce corruption, improve transparency in public spending, good governance, etc.).
- Frame GFR in relation to **international & regional commitments** (e.g. CBD, Rio+20, G20, APEC, EU).

Communication and engagement

- **Build broad political and public support** throughout GFR process.
- **Target and tailor** communication and engagement to specific external and internal actors.

Externally

- Key stakeholders, interest groups, wider public, parliamentarians.
- Focus on benefits to people's everyday lives.
- Transparent on pros and cons of reform.
- Compensation for vulnerable groups
- Highlight successful reforms in other countries.

Internally

- Between government departments to ensure 'whole of government' approach.
- Set up cross-departmental working group/task force.
- Encourage cooperation and open, honest discussion.
- Transparent on pros and cons of reform.

Monitoring and review

Regular and transparent monitoring and review to reassess impacts, ensure effectiveness, implementation of commitments and inform future revisions.

National level

- Monitor revenues raised & use to assess implementation of commitments, reduce risk of corruption
- Review need to change mitigation measures and design

Regional level

- Voluntary peer-review processes under G20 & APEC on inefficient fossil fuel subsidies
- European Semester process in the EU

International level

- Reporting under the CBD on progress reforming incentives harmful to biodiversity

Moving forward with GFR

- GFR requires a **comprehensive, integrated and consultative approach** reflecting good governance principles.
- Despite good intentions and due processes, GFR efforts sometimes fail (e.g. Australia, Nigeria, Bolivia), thus also requires **broad public support and political capital** over time.
- Need a **pragmatic approach**, allow for certain deviations from ideals as a politically expedient way to make progress.
- Some countries are already **seizing current opportunities for GFR** (e.g. India, Indonesia, Ireland, Italy, Portugal etc.). **Others should be encouraged to follow their lead.**

Thank you for your attention

Sirini Withana – swithana@ieep.eu

Draft paper on ‘Overcoming obstacles to green fiscal reform’ available at:

[http://www.greengrowthknowledge.org/sites/default/files/Withana Overcoming obstacles to green fiscal reform.pdf](http://www.greengrowthknowledge.org/sites/default/files/Withana%20Overcoming%20obstacles%20to%20green%20fiscal%20reform.pdf)

Insights Blog post on ‘Making green fiscal reform happen’:

<http://www.greengrowthknowledge.org/blog/making-green-fiscal-reform-happen>

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