

# FOSSIL FUEL SUBSIDY REFORM: LESSONS AND OPPORTUNITIES

COVID-19 and the climate crises are closely intertwined while both act as poverty multipliers that pose an acute threat to vulnerable populations. As countries prepare for the post-COVID era by developing stimulus plans for economic recovery, governments face a crucial choice: to postpone the transition from fossil fuels to renewables or embarking on the transition now. This includes the opportunity to phase out subsidies that support fossil fuels.

Global energy subsidies to consumers cost around US\$425 billion in 2018. An additional \$70–\$100 billion per year in subsidies are allocated to fossil fuel producers globally. Heavily subsidized fossil fuel energy prices encourage wasteful use, disincentivize energy efficiency, and make it hard for renewables to compete and enter the market. These subsidies are also regressive, with the wealthiest 20 percent of the population reaping 43 percent of the benefit, versus less than 10 percent to the poorest.

Correctly pricing the true social, economic and environmental costs of fossil fuels will create the much-needed fiscal space to attain an inclusive, green recovery that benefits more people, combats climate change, and helps countries reach their Sustainable Development Goals.

A clear understanding of the existing levels of subsidy support, as well as of the distributional impacts of withdrawing it, considering specific vulnerabilities and adaptive responses, particularly among the poorest households, would allow revenues to be spent on health, education, new jobs, and focus on increasing development and well-being.

## Four key policy recommendations for designing and implementing fair fossil fuel subsidy reform:



**A better understanding of the socio-economic contexts of communities likely to be affected by such reforms:** Undertaking successful fossil fuel subsidy reform requires a clear analysis of existing levels of subsidy support, the reasons for their existence in the first place, as well as the distributional impacts of withdrawing it. A key factor is stronger expenditure survey data and accompanying analysis, complemented by qualitative research into local vulnerability and the spillover effects of subsidies.



**Timing and sequencing of reforms:** Governments should enact a phased approach to price reform to enable households and firms to adjust wherever possible, while recognizing that windows of opportunity may warrant a step-change in pricing policies.



**Compensation and wider expenditures, including capacity to deliver:** Fossil fuel subsidy reforms need to include compensatory measures that target the poorest and most affected households, including developing social safety nets. They should focus on reinforcing existing social welfare benefits, including cash transfer mechanisms and temporary basic incomes.



**Communication strategies and stakeholder engagement:** Policymakers should conduct effective public communication, and deep stakeholder engagement to secure buy in across society and different sectors. Public support is fostered when the environmental effectiveness and/or progressive distributive impacts of reform are clearly explained and demonstrated. One pillar for success is building consensus around key approaches to implementing reforms, working closely with experts and opinion leaders.