Fossil Fuel Subsidy Reforms
Development context

The Sustainable Energy Hub

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Don’t Choose Extinction
UNDP Flagship Campaign since 2021

High-level advocacy on Fossil Fuel Subsidy Reforms
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High-Level Policy Recommendations for Energy Pricing in Developing Countries

Policy brief released at COP27

Policy Considerations: The Overarching

Policy makers need to be cognizant and be able to effectively communicate the fact that low energy prices are an important element of the underlying social contract.

A sound social contract is underpinned by two principles of fundamental securities and free prices. As an aspect of this contract, the government undertakes to provide six fundamental securities to its people: (4) national security; (5) food security; (6) energy security. (6) social security (including health, education, and social protection for the poor and vulnerable); (7) economic and financial security and (8) environmental security. In return, people undertake to (9) support the love of country and (10) pay fair price," which is enshrined in law, as well as the rates for the public services they consume based on the costs to deliver them. If energy products are priced fairly, the government does not need to compensate utilities and other energy companies for their losses. Its fiscal position is therefore strengthened, which allows it to provide for all fundamental securities in a consistent and sustainable manner. In addition, for prices for energy products will curb wasteful and excessive consumption of energy, in particular fossil fuels, that would undermine economic, financial, and environmental security.

Countries without fair energy prices but instead resorting to heavy subsidization of fuel and electricity in wake of price increases are significantly undermining their fiscal and external stability, compromising on the social contract and distorting their energy transition and net zero ambitions.

This could undermine years of human development progress in countries. Over 1 billion countries globally, are currently being hit by economic prospects. The economic costs are jointly obligated to policy of heavy and unregulated subsidization which causes significant fiscal and external deficits, compromising government ability to protect the most vulnerable and high climate change. Even among stronger economies, income-poor populations are becoming a major fiscal and external burden - with high opportunity cost. Money that could be better used for strengthening social protection, provide improved economic stimulus and countering climate change.

Policy Considerations: The Specifics

Refining subsidised energy prices should be a gradual process. It is necessary to gradually phase-in or to not overburden consumers with large price increases at one time and allow time to adapt alternative strategies. In addition, regular price adjustments will be required once the base level has reached to ensure pass-through of international prices to domestic prices and social safety net mechanisms. A particular policy measure that could be employed by developing countries to effectively remove and then also avoid subsidies whilst offering some protection against shocks is an automatic fuel price mechanism (AFPM) with a smoothing factor. An AFPM can effectively align domestic energy prices with the international market, especially with a short time lag. A smoothing factor will ensure that periodic price adjustments avoid large changes at times of high price volatility, especially when prices are rising. Several developing countries have implemented AFPMs in the past such as for example Jordan, Indonesia and Egypt and in recent times many countries in crisis have adopted the measure as a means of limiting fiscal and external headroom and part of recovery policies (such as for example Sri Lanka and Pakistan). Clearly, an AFPM should be implemented through a de-politicised institutional mechanism that limits political-government interference in the scheme allowing for its independent and effective functioning.

Over the long term, fair energy prices should also embody progressive carbon taxes.

Carbon taxes target implied subsidies or those that account for the positive externalities of fossil fuel use, such as air pollution, traffic congestion and of course climate change. Carbon taxes could be imposed in any number of ways – such as for example border taxes (green taxes, environment levies etc and it is estimated that around 30 countries currently have some form of carbon tax systems). These carbon taxes (in whatever form they are imposed, should be based on two considerations of justness: (a) to pay (that is environmental/social impact of emissions) and who could pay (heavily taxed individuals) and should also be phased in gradually over time.
UNDP Fossil Fuel Subsidy Reforms Offer: Integrated agenda for a just and inclusive transition

**TWO KEY PILLARS**

1. **Partnerships**
   - Global/Regional
   - Local

2. **Packaging**
   - Energy Security
   - Green recovery/growth
   - Decarbonization/NZT

**OFFER ELEMENTS**

- **Support to external clients**
  - Governments

- **Support to internal clients**
  - UNDP Country Offices,
    - Other UN agencies

- **Supplementary services**
  - Knowledge Products
  - Facilitation of Knowledge-sharing
    - Global, regional, country-level dialogues
FOSSIL FUEL SUBSIDY REFORMS
POLICY FRAMEWORK

Key tools for external client support

Fossil fuel subsidy reforms strategy

- Economic, Environment, Social and Poverty Assessment (ESPA)

Governance and institutional mechanisms

- Governance, Institutional and Capacity Assessment (GICA)

Strategy pillars:
- Prioritization, sequencing, phasing of reforms
- Use of fiscal savings

Establishment of governance and institutional mechanisms:
- Capacity development
- Depolitization of reforms
- Automatic Pricing Mechanisms (APM)
- Smoothing mechanisms

STAKEHOLDER ENGAGEMENT AND COMMUNICATIONS

IMPLEMENTATION OF FOSSIL FUEL SUBSIDY REFORMS

POST-IMPLEMENTATION RESULT MONITORING
Underlying social contract, underpinned by two principles:

- Government ensures six fundamental securities
  - national security
  - food security
  - energy security
  - social security (health, education, and social welfare)
  - economic and financial security
  - environmental security

- People pay a fair price

Fossil Fuel Subsidy Reform:

- Government part of the contract: freeing fiscal space to ensure fundamental securities
- People side of the deal: fair price for fuel/electricity, fair taxes

This makes the whole system sustainable.
First order subsidy reforms and institutionalization in Sri Lanka and Pakistan helped stabilization and curtailing fiscal and external hemorrhage.

Fossil Fuel Subsidy Reform has considerable utility for:

- Support Energy Transition: e.g. MOVES project in Uruguay
- Ramping up social protection, social welfare and poverty alleviation measures: e.g. India, Mauritania, Indonesia and others
- Invigorate economic growth (investments in climate resilient and green infrastructure) and facilitate economic diversification: e.g. Initiatives underway in the GCC.
Supporting innovation, technology and entrepreneurship in developing countries, providing a permanent fillip to economic growth.

Supporting broader decarbonization efforts that spans a broad spectrum (energy, agriculture, transportation, industry, land use and waste management) towards systems change and a different way of approaching economic development policy. In many developing countries, energy transition will not happen in the face of continued subsidization of fossil fuels.

Fiscal savings could be used to securitize thematic debt issuances (Green Bonds, Sustainability Linked Bonds etc) or create collateral funds for de-risking both debt and equity resources for development.
Thank you.

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