

Temporary Fossil Fuel Support Measures and Phase-Out Best Practices



Highlights from Factual Note by the WTO
Secretariat

Temporary Support Measures Introduced in Response to Energy Crises



Support measures in response of the 1973 oil crisis

A process of fuel substitution and electricity generation moving away from oil and natural gas towards coal and nuclear power; a period of energy innovation and investment in renewables

Demand side:

- Fiscal incentives to develop more energy-efficient technologies and measures to promote changes in consumer preferences
- A wave of technology innovations that continue to deliver increased efficiency, e.g. turbocharging, lightweight materials, front-wheel drive

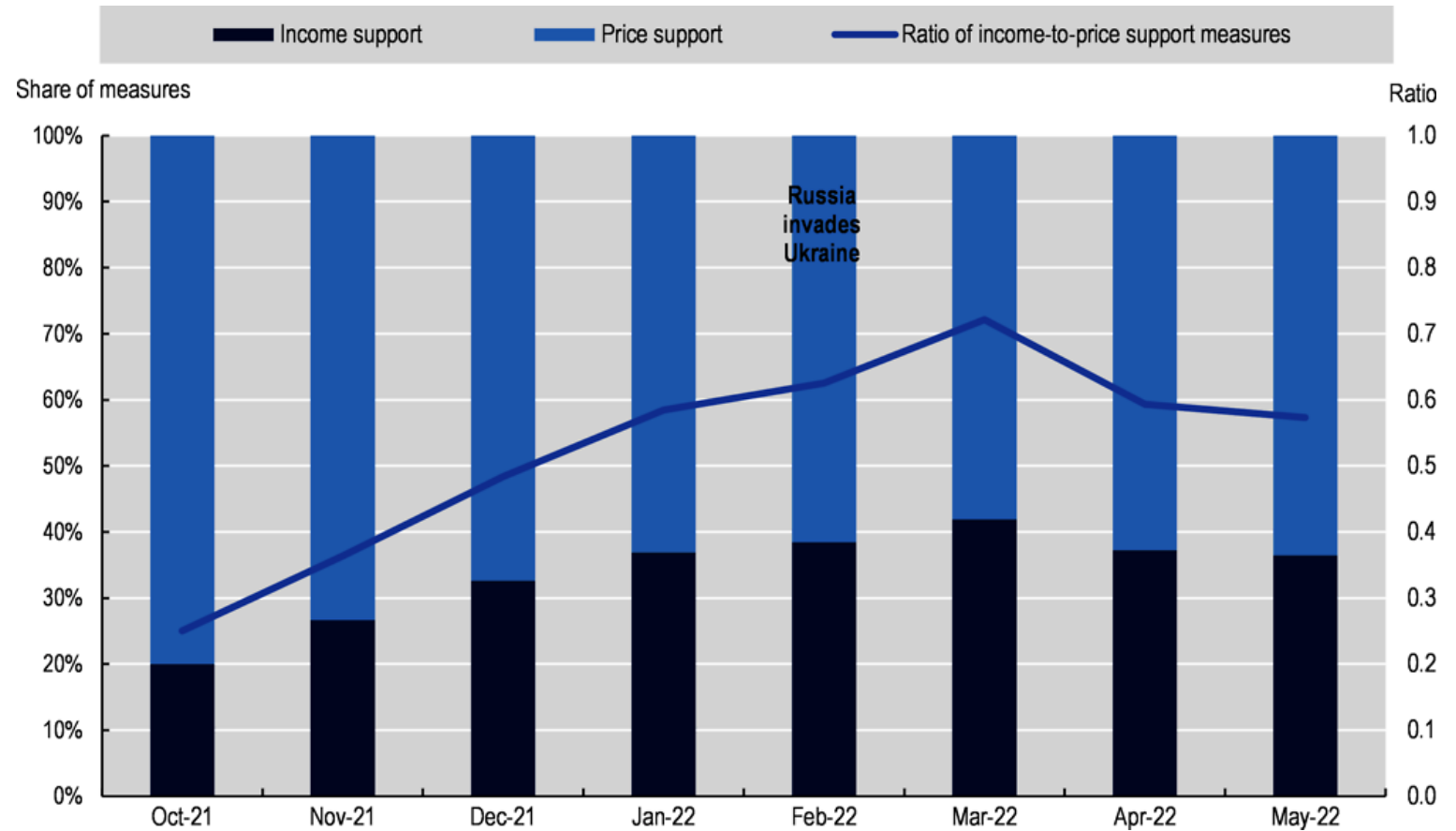
Supply side:

- Mandate to sharply increase the use of biofuels
- Tax incentives for fossil fuels, nuclear, and renewable energy; loan guarantees for zero-carbon technologies

The International Energy Agency established to monitor the development of energy markets and promote common policy making

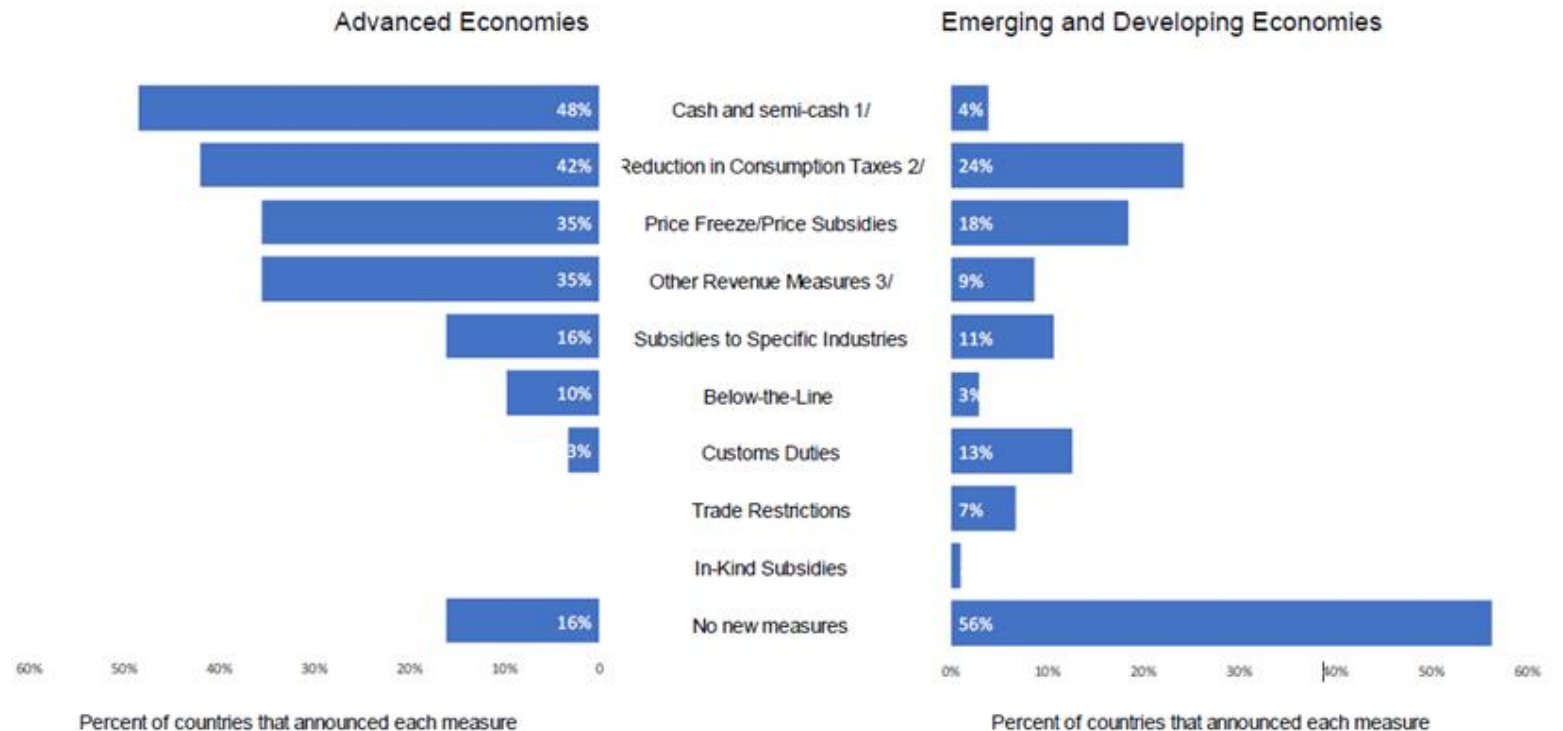
Policies encouraging the use of coal and price controls led to environmental problems and market distortions

Governments' responses to the recent energy crisis have focused largely on price control



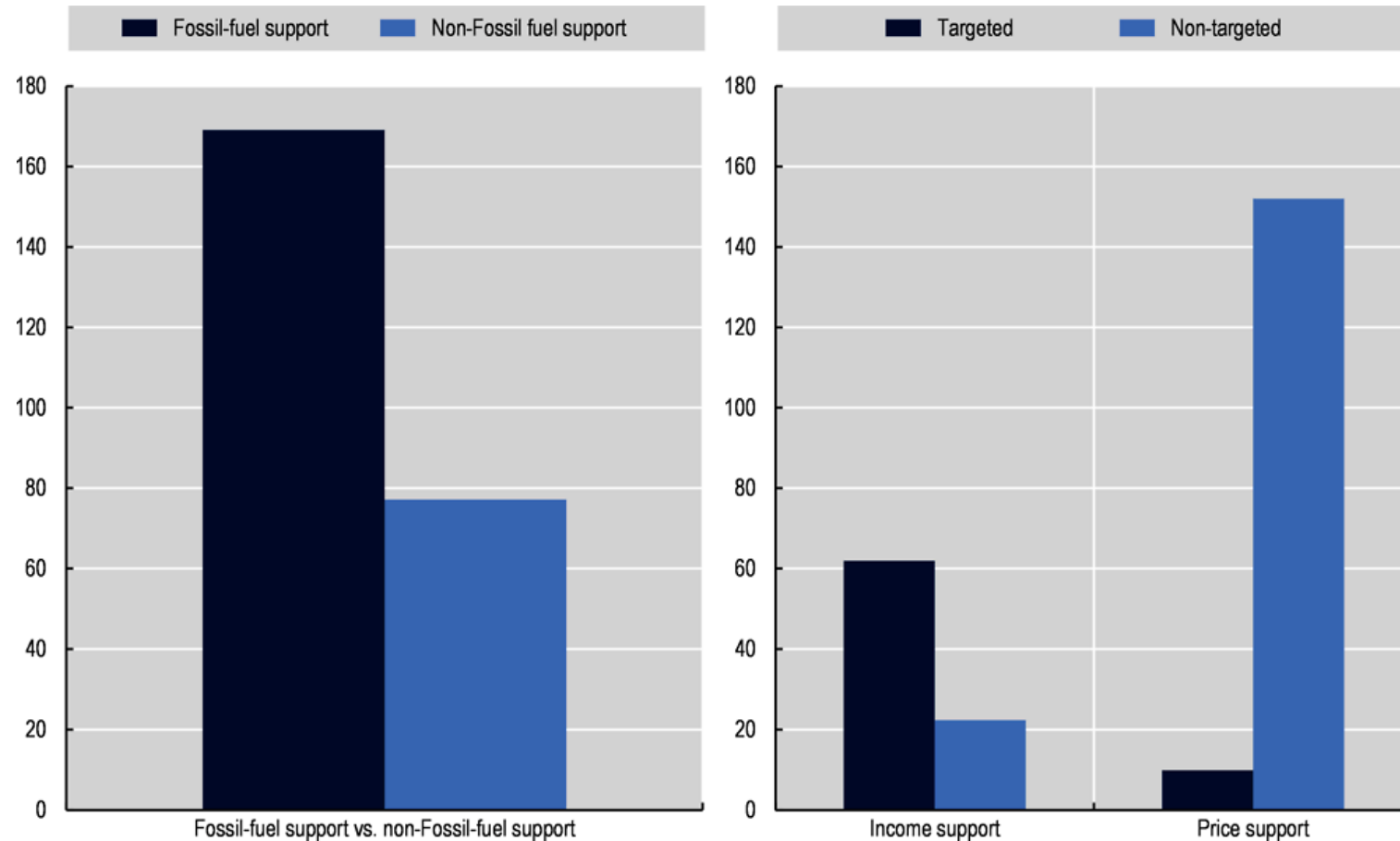
Source: OECD 2022

Most economies
have announced
at least one
measure since the
beginning of 2022



Source: IMF 2022

The aggregate fiscal cost of measures between October 2021 and December 2022 amounts to USD 246 billion of which USD 169 billion in the form of support for fossil fuels

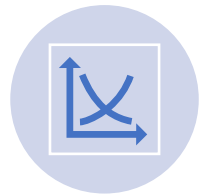


Source: OECD 2022

Lessons Learned for Designing Temporary Support Measures



Governments' responses vary based on energy mix and end-users' vulnerability to price shocks



Energy prices: wholesale/retail price ceilings or caps, price freezes, limits on pass-through



Energy bills: bill discounts/deferrals, instalments, moratorium on utility disconnections for non-payment



Taxes: VAT, fuel, excise, or carbon tax reductions for electricity or fuels, corporate tax deferrals



Social protection: cash transfers to households, expanded benefit schemes



Support to sector companies: fiscal transfers to oil and gas companies, utilities, interest-free loans, guarantees, relaxed state-aid rules



Support for energy consuming enterprises: fiscal transfers to firms, such as transport operators, farmers, textiles; debt relief, restructuring

Policy responses must be based on an assessment of fiscal and welfare trade-offs



Affordability: impact on fiscal stability



Predictability and control of cost: ability to set upper limits for the cost of a programme and reasonably predict costs



Targeting: limiting benefits to specific businesses, population groups, or activities



Abuse resistance: ability to control abuse by eligible beneficiaries and other parties involved



Reversibility: ability to withdraw response when appropriate without causing economic and behavioural distortions



Strength of social safety nets

Moving away from price support measures

Allowing domestic prices to follow international prices (**pass-through**)

- Measures are an inefficient tool to protect the vulnerable, are fiscally costly, and mute the demand adjustment to the price shock (including energy-conserving behaviour and energy efficiency investments)
- Energy tax reductions also weaken price signals and the incentives to reduce consumption levels

Flexible approaches to reduce demand and redistribute the energy sector's surplus revenues and profits

- A mandatory cap on market revenues of electricity producers
- A temporary solidarity contribution on the surplus profits of businesses

Focusing on targeted and income-based support

Income support for vulnerable households without distorting the marginal price they pay for energy

Targeting of support based on **criteria beyond income** (e.g. housing location and quality, and household composition)

Innovations in transfer **mechanisms** to reach the most vulnerable groups and facilitate targeting (e.g. digital delivery methods for transfers)

Robust information systems at the level of national social security to ensure efficient targeting (e.g. creating consumer databases)

Targeting also important when providing **support to firms** (e.g. on companies suffering from liquidity/solvency problems deriving directly from the crisis)

Careful design in **taxing windfall profits** of energy producers (e.g. of extractive industries to help offset the costs of relief policies)

Embedding time-limits, reviews, and sunset clauses


Time-bound measures with clear end-dates and, if need be, extension mechanisms



Regular review clauses to ensure that measures remain temporary



Sunset clauses to set an explicit expiration date, prevent temporary support from operating indefinitely and give stakeholders a clear expectation reducing lock-in risks

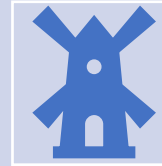


Built-in transition mechanisms, such as gradual increases in electricity prices to adapt to international prices, as well as to ensure smooth and progressive adaptation

Encouraging energy efficiency



Importance of recognizing the potential of energy efficiency and conservation as **the "first fuel"** and ensuring that short-term measures do not disincentivize energy efficiency and conservation



Countries that placed an **emphasis on energy efficiency** over the last few decades now see lower consumer costs, lower fuel imports, and lower emissions (e.g. upgrading the efficiency of homes and buildings, encouraging people to reduce consumption)



The pandemic has shown how **creative communication** relaying trustworthy and consistent information can lead to strong engagement (e.g. campaigns incentivizing switching to energy-efficient equipment)



Steps that businesses can take to use energy more efficiently and wisely, making them more resilient and secure

Accelerating the green transition



Accelerating the green transition is seen as **the best way to limit vulnerability** to spikes in fossil fuel prices and enhance energy security



Policy measures aimed at accelerating the development of alternative sources of energy, e.g. supporting energy efficiency improvements and ensuring that networks/infrastructure are adapted to zero-carbon technologies



Scaling up of investment in renewable energy development, while ensuring the availability of a low-emission and diversified fuel and energy trade mix



Measures that give temporary relief from peak prices could **transition to the introduction of carbon taxes** to ensure carbon prices remain at a level consistent with climate mitigation objectives in the medium- to long-term

Phase-out considerations

- A case for **starting with the least targeted** measures; if an extension of support measures is considered necessary, better targeting and refraining from generalized support should also be considered
- A need to **phase out costly measures and identify sustainable revenue sources** (e.g., new or increased carbon taxes to come into effect when international energy commodity prices fall) to finance targeted support
- **Benefits** of policies to counter the effects of high energy prices to be **weighed against the economic cost of financing** such policies by raising additional revenues or cutting other expenditures



Fostering international cooperation

A need for **economic support to be coordinated** across countries to discourage arbitrage

More coordination between countries and between the public and private sectors ensures that **energy security strategies** consider the implications on energy transition

Developing countries may need support from the international community to mitigate adverse impacts on their economies, households, and businesses

Voluntary, bottom-up, cross-country **peer reviews** of governmental support have been shown to lead to improvements in valuation and legitimacy