



## A GUIDE TO ECONOMIC AND POLITICAL COMPLEXITY OF FOSSIL FUEL SUBSIDY REFORMS

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*A new book explores the complex economics and politics of fossil fuel subsidies, and distils key principles for designing and implementing of effective reforms. [Fossil Fuel Subsidy Reforms: A Guide to Economic and Political Complexity](#) (Routledge)*

### **Expensive and counter-productive**

In recent years, governments around the world have been subsidising fossil fuel production and consumption at a cost to tax payers of up to US\$ 1 trillion each year. While this sum tries to make the fossil fuel industry competitive and fossil energy more affordable, the societal costs of these subsidies are enormous – for instance due to economic inefficiency, inequality, air pollution, and climate change. In fact, fossil fuel subsidies (FFS) have the polar opposite effect of carbon taxes: They incentivise the overconsumption and inefficient use of carbon-intensive energy and undermine the effectiveness of any climate change mitigation effort. In addition, FFS drain funds from essential public spending in health, education, and social protection.

The wide range of economic and social externalities associated with FFS emphasises that reform is a vital contribution to sustainable development objectives. Indeed, FFS reform can play a vital role, for instance, in the reduction of poverty and inequality (SDGs 1, 10), promotion of sustainable energy, industrialisation, cities, and transport (SDGs 7, 9, 11, 12), mitigation of climate change and local pollution (SDGs 11, 13), and reduction of illicit activities and corruption (SDG 16). The book shows that FFS reform not only removes distorted incentives that undermine countries' ability to make progress towards these goals, but can also unlock significant domestic financing to facilitate and accelerate sustainable development efforts.

### **Reforms: We know why, the question is *how***

Yet, despite strong drivers for FFS reforms – fiscal strains on national budgets, adverse environmental impacts, and international commitments – overall progress at the country level has been limited and the track record is mixed. Various countries have experienced first-hand the political challenges associated with FFS reform. Especially when reforms were poorly designed or implemented, strong public opposition

has repeatedly forced governments to abandon reform attempts. This is not least due to the fact that energy pricing reforms will directly affect the disposable income of consumers and operating costs of firms. Nevertheless, various cases of past FFS reforms also illustrate that thorough planning, risk assessment, and policy design can enable successful reforms.

However, the book also emphasises that effective reforms need to be pragmatic. When FFS reforms are implemented in practice, environmental objectives often play a secondary role. Instead the rationale for FFS reforms are determined within a complex – and sometimes conflicting – context of fiscal, macroeconomic, political, and social factors. In the past, governments have focussed in particular on the fiscal dimension of FFS reform, i.e. relieving public budgets by removing FFS, and avoiding public opposition by compensating the losers of reform.

However, by focussing on managing the down-side risks of reforms, the full sustainable development potential associated with subsidy reform may fail to materialise. Thus, complementary measures and prudent reinvestment of reform revenues are critical to ensure that FFS reforms not only provide short-term relief during fiscal crises, but also serve as a fully integrated component of a long-term sustainable development strategy.

Assessment of subsidies & pricing mechanisms	Building public acceptance	Social protection & compensation	Revenue redistribution & reinvestment	Complementary measures	Timing & price smoothing
Definition	Communication strategies	Compensate vulnerable households (e.g. cash transfers)	Infrastructure investments	Support for energy/material efficiency & innovation	Sequencing reforms for different fuels
Identification			Public spending (e.g. health, education)	Infrastructure investments	Gradual subsidy reductions
Measurement & estimation	Mapping of interest groups	Support firms (energy access & efficiency programs)	Institutional reforms	Training & capacity building	Phase out ad-hoc pricing
Assess social costs, incl. illicit activities		Social safety nets	Tax cuts (e.g. labour taxes)	Reform market structures	
Assess potential reform impacts	Stakeholder identification & engagement	Anti-inflationary policies	Direct transfers ("resource dividend")	Complementary fiscal reforms	Automatic fuel pricing & price smoothing mechanisms

*Key elements of a comprehensive fossil fuel subsidy reform package (Rentschler 2018)*

**A guide to the economic and political complexity of reform**

This book provides policy makers and researchers with a guide to the complex challenge of designing, and implementing effective fossil fuel subsidy reforms. According to [Marianne Fay](#), Chief Economist for Sustainable Development at The World Bank, “the sheer magnitude of fossil fuel subsidies being paid globally also hints at the size and complexity of the challenge. To reform subsidies means to understand and gauge economic and political trade-offs, to mitigate adverse effects on vulnerable households, to assist firms with implementing efficiency enhancing measures, and to ensure the long-term contribution of subsidy reform to sustainable development. This book explores these issues, with the objective of informing the preparation, design, and implementation of effective fossil fuel subsidy reforms.”

By going beyond the purely fiscal perspective, well designed subsidy reforms can contribute to all three dimensions of sustainable development – environment, society, and economy. Indeed, FFS reform is not only about removing subsidies, but requires a range of carefully designed and sequenced policy measures:

For instance, communication and compensation are key to building acceptance and protecting livelihoods. By establishing or strengthening social protection systems governments can help protect people against adverse shocks – not only from energy prices. Targeted support measures for enhancing efficiency, fuel switching, and innovation can help firms maintain – or even increase – their competitiveness. Infrastructure investments in public transport or electricity can increase service quality and enable the substitution away from polluting and inefficient technologies. Transparent systems for the reinvestment and redistribution of reform revenues can form the basis for the sustainable management of natural resource rents.

Over the course of eight chapters, this book explores the implications of FFS reforms on poverty rates, household welfare, firm competitiveness, and macroeconomic performance. It considers a wide range of policy strategies for managing the risks of reform while seizing the opportunities, and distills the key principles for designing effective fossil fuel subsidy reforms.

Reference:

Jun Rentschler. 2018. [Fossil Fuel Subsidy Reforms: A Guide to Economic and Political Complexity](#). New York: Routledge



## ABOUT THE AUTHOR

Jun Rentschler is an economist at the World Bank working at the intersection of climate change and sustainable resilient development. He is also a visiting research fellow at the Payne Institute for Earth Resources and the Oxford Institute for Energy Studies. Prior, he spent two years as a consultant at the European Bank for Reconstruction and Development, working on private sector investment projects in energy and resource efficiency. He also served as an economic adviser at the German Foreign Ministry, where he focused on economic and energy policy.

Rentschler holds a MSc and a PhD in economics from University College London, with a specialization in the fields of development, climate, and energy. He has published widely on these topics, including in academic journals and his books 'Fossil Fuel Subsidy Reforms: A Guide to Economic and Political Complexity' (Routledge, 2018) and 'Investing in Resource Efficiency: The Economics and Politics of Financing the Resource Transition' (Springer, 2018). He is part of the World Bank's Young Professionals Program.

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