



## **Fossil Fuel Subsidies Don't Protect the Poor**

### ***And reform frees up resources to fund better safety nets and cleaner energy***

At around \$409 billion in 2010 and growing to potentially \$630 billion in 2012<sup>1</sup>, fossil fuel consumption subsidies in developing countries rarely benefit the poor, despite being justified as either a means of helping the poorest households or necessary to provide energy access to those without electricity or modern cooking facilities.

The truth is these subsidies more often benefit the elites and upper classes than the poor in developing countries.<sup>2</sup> To add insult to injury, major multilateral development banks claiming that their missions are to combat climate change and finance energy access to the poor are more often lending to large fossil-fuel dependent energy projects than to projects to bring clean, renewable energy access to the people who need it the most.

### **Breaking down the numbers**

Several studies in recent years have quantified fossil fuel consumption subsidies and examined whether they are effective tools for poverty alleviation. Generally, lower-income populations only receive a tiny share of the benefits and fossil fuel consumption subsidies are not an effective strategy to protect "real incomes of poor households, since they involve substantial leakage of benefits to higher-income groups."<sup>3</sup>

***Of the \$409 billion total in consumption subsidies in 2010, the International Energy Agency (IEA) found that only \$35 billion, or just 8 percent, reached the poorest 20 percent of income groups.*** Furthermore, a survey of eleven developing economies comprising 3.4 billion people found that only 2 percent to 11 percent of the poorest populations were actually benefitting from fossil fuel subsidies. South Africa had the lowest share, 2 percent, of poor beneficiaries.<sup>4</sup>

Energy financing from multilateral development banks, including the World Bank Group and regional development banks, also does not achieve the aim of increasing energy access for the poor. A study by Oil Change International of the 2010 energy financing by multilateral development banks found ***that of the total US\$41.6 billion in energy financing in 2010, just \$1.6 billion, or less than 4 percent, was explicitly directed to projects and programs to provide energy access for the poor.***

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<sup>1</sup> Fatih Birol, IEA Chief Economist, on April 2, 2012, available at <http://www.iea.org/weo/quotes.asp>.

<sup>2</sup> IEA WEO 2011

<sup>3</sup> IMF Working Paper, "The Magnitude and Distribution of Fuel Subsidies: Evidence from Bolivia, Ghana, Jordan, Mali, and Sri Lanka", WP/06/247, available at

"<http://www.frp2.org/english/Portals/0/Library/Fiscal%20Policy/The%20Magnitude%20and%20Distribution%20of%20Fuel%20Subsidies%20.pdf>.

<sup>4</sup> IEA WEO 2011, page 45.

This against the pressing need to provide energy access to around 1.3 billion people worldwide and clean cooking facilities to 2.7 billion people, mostly living in rural sub-Saharan Africa or developing Asia. On this point, the IEA observes that “at present, energy access funding tends to be directed primarily toward large-scale electricity infrastructure. This does not always reach the poorest households. Access to funding at a local level is essential to support initiatives that cater effectively for local needs, building local financial and technical capacity and stimulating sectoral development... The prize would be a major contribution to social and economic development, and helping to avoid the premature death of 1.5 million people per year.”<sup>5</sup>

### **Here is why fossil fuel consumption subsidies just don't work**

Fossil fuel consumption subsidies are often justified to offset the costs of petroleum, liquid petroleum gas (LPG), kerosene and electricity. Subsidies intended to reach the poor are often economically inefficient because richer households use more fuel and benefit much more from the subsidy, while poor households are only able to afford a small amount, even at subsidized rates. Artificially low prices can also lead to the fuel being diverted to other uses than for which the subsidy was intended, including selling fuel across borders or on the black market or being used for less efficient end uses.<sup>6</sup>

The UN Environment Program also points out that energy subsidies can hurt the poor in other ways, specifically by supporting conventional, centralized energy over small-scale, distributed, labor intensive alternatives. This can mean fewer job opportunities within a community and can also mean more pollution from power plants and refineries, which the poor are less able to move away from.<sup>7</sup>

The Vasudha Foundation conducted on-the-ground surveys of energy services to the poor in eight states in India and found that in “almost every policy design, subsidies and budgetary allocations intended to benefit the poor, end up benefiting primarily the well-off sections of the society thereby compounding the continuously ‘poor’ state of India’s rural energy infrastructure.”<sup>8</sup>

In electricity subsidization, where the generation is dependent on coal, oil or gas, subsidies assist households that are already connected to a grid. In India, for example, this accounts for only about 56 percent of the population. Gasoline and diesel subsidies benefit people who own cars or other vehicles. In this case, poorer households simply cannot afford the car, let alone the fuel. Vasudha found that “the case remains the same with regard to the supply of other energy fuels, such as liquefied petroleum gas (LPG) and kerosene, with the urban rich being the major beneficiaries of these subsidies with very little trickling down to the rural population.”

### **Better policy tools exist to protect and provide energy access to the poor**

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<sup>5</sup> Ibid., page 469.

<sup>6</sup> “Reforming Energy Subsidies: Opportunities to Contribute to the Climate Change Agenda,” United Nations Environment Programme Division of Technology, Industry and Economics, 2008.

<sup>7</sup> Ibid.

<sup>8</sup> Krishnaswamy, S. and Chatpalliwar, S. “Energy Services to the Poor: Are they truly subsidized? An assessment of ‘Economics and Willingness to pay’” Vasudha Foundation and & Samvad, November 2011, available at [http://vasudha-india.org/publications/900385358\\_Energy%20Services%20to%20the%20Poor%20-%20Are%20they%20Truly%20Subsidized\\_November%202011.pdf](http://vasudha-india.org/publications/900385358_Energy%20Services%20to%20the%20Poor%20-%20Are%20they%20Truly%20Subsidized_November%202011.pdf).

Fossil fuel consumption subsidies are a drag on developing-country economies and much could be saved and invested in more efficient, well-targeted social safety nets, social services and decentralized, renewable energy services. According to a Global Subsidies Initiative review of six respected modeling and empirical studies of fossil fuel subsidy reform, all of the studies the review examined, “found that fossil-fuel subsidy reform would result in aggregate increases in gross domestic product (GDP) in both OECD and non-OECD countries. The expected increases among the studies ranged from 0.1 per cent in total by 2010 to 0.7 per cent per year to 2050.”<sup>9</sup>

Reform is tricky, however, and social unrest has erupted during national efforts to eliminate consumption subsidies, demonstrating how carefully efforts need to be designed and implemented. Where subsidy reform has been successful, social safety nets, including targeted payments to the poorest in a population have been effective. One study on the effectiveness of 24 targeted cash or near-cash transfer schemes, found that their use “has been relatively successful in ensuring that the benefits reach the poor. Out of 24 schemes analyzed for the period 2005–2008, two thirds were transferring more than half of the funds to the poorest quartile of the population.”<sup>10</sup>

In addition to social safety nets, developing countries that opt for fossil fuel subsidy reform will free up resources to expand access to cleaner and cheaper forms of energy development for their populations. This point was well made recently by the IEA in an article in the Guardian:

Sub-Saharan Africa received about \$15.6bn (£9.7bn) in overseas development aid last year, but this was outweighed by the \$18bn cost of importing oil. Fatih Birol, IEA’s chief economist said, “If you diversify the sources of energy, that is a good thing and clean energy means using free, homegrown resources so that will bring down the import bill.” When industrialised economies were developing, oil was the equivalent of \$13 a barrel, but now developing countries must pay \$120 to \$130 a barrel<sup>11</sup>.

Clearly, fossil fuel consumption subsidies are punishing the poor in more ways than one: they divert resources from important social programs and they lock countries into highly fossil fuel addicted development pathways, throwing up barriers to decentralized, renewable energy. It is time to bring down these barriers, strengthen social safety nets, and protect people and the environment.

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<sup>9</sup> Jennifer Ellis, PhD, For the Global Subsidies Initiative (GSI) of the International Institute for Sustainable Development (IISD), “The Effects of Fossil-Fuel Subsidy Reform: A review of modelling and empirical studies.” Geneva, Switzerland: March, 2010.

<sup>10</sup> “Subsidies in the Energy Sector: An Overview,” Background Paper for the World Bank Group Energy Sector Strategy, July 2010, available at [http://siteresources.worldbank.org/EXTESC/Resources/Subsidy\\_background\\_paper.pdf](http://siteresources.worldbank.org/EXTESC/Resources/Subsidy_background_paper.pdf).

<sup>11</sup> IEA, April 2, 2012, available at <http://www.iea.org/weo/quotes.asp>.