



The First G-20 Fossil Fuel Subsidy Peer Review

Insights and Lessons from the United States and China

By Pete Ogden and Howard Marano October 2016

In 2009, G-20 countries made a commitment to phase out wasteful fossil fuel subsidies.¹ Doing so would constitute an important step forward in meeting the climate challenge and promoting sustainable economic growth at home and abroad. Fossil subsidies tilt the energy playing field away from renewable energy sources and encourage energy waste. Moreover, they are frequently regressive: In developing countries, the richest 20 percent of the population captures, on average, six times more of the value of fuel subsidies than the poorest 20 percent.²

While progress toward subsidy phaseout has been fitful and slow—though with some bright spots—G-20 countries have fortunately not backed away from this commitment. In an effort to build momentum for this effort, the G-20 finance ministers announced in 2013 a new peer review program in which countries could voluntarily engage in an information-sharing and consultation exercise designed to shed light on their own subsidies and how to address them.³

The United States and China stepped forward as the first two country volunteers to participate in the peer review program. Both countries submitted self-reports identifying and explaining their respective fossil fuel subsidies, and then each country reviewed the other's self-report. Germany, Mexico, Indonesia, the Organisation for Economic Co-Operation and Development, and the International Monetary Fund also reviewed the U.S. and Chinese reports. All of the reviewing parties also participated in an in-country meeting where they were able to engage with the relevant government authorities, ask questions, and help identify opportunities and barriers to reform. The results were released publicly on the heels of the G-20 meeting in Hangzhou, China, last month.⁴ The first peer review produced useful findings and insights for both countries as they move toward dismantling inefficient subsidy programs. The G-20 should now chart a course forward that builds on these accomplishments and creates a more robust process for subsequent rounds of review.

What we have learned?

The United States

The peer review process of the United States surfaced an assortment of inefficient subsidies—some previously acknowledged by the United States, others not—that were largely confined to upstream activities, including the exploration, development, and extraction of fossil fuels.⁵

At approximately \$1.6 billion annually, the largest subsidy identified was the expensing of intangible drilling costs, which allows a company to deduct the costs of nearly all expenditures in preparing a well. Other large subsidies included a tax deduction for domestic manufacturing, which can be applied to the fossil fuel sector, and percentage depletion for oil and natural gas wells, which effectively provides a lower tax rate for those industries. Annually, these subsidies were found to cost approximately \$1.05 billion and \$0.97 billion, respectively.

Two policies—the enhanced oil recovery, or EOR, credit and the marginal wells credit—were recorded as having no cost. In both cases, this was because the price of oil is not projected to fall below the reference level required for these credits to become available. Additionally, the cost of the liability cap on natural resource damages was not estimated because there have been no spills in which this provision has lowered a responsible party's liability.⁶

The United States previously submitted reports on its fossil fuel subsidies to the G-20, but this round of peer review revealed six additional subsidies that were not included before now: the corporate income tax exemption for fossil fuel publicly traded partnerships, the excise tax exemption for crude oil derived from tar sands, the royalty-exempt beneficial use of fuels, the royalty-free flaring and venting of natural gas, and the liability cap on natural resource damages.⁷ The fact that these additional policies were included in the peer review demonstrates that this process enabled the United States to undergo a deeper self-assessment of its fossil fuel subsidies and is a step toward further transparency.

Peer reviewers also identified several fossil fuel subsidies that were acknowledged by the U.S. Energy Information Administration for fiscal year 2015 but not included in the U.S. self-report because they are set to expire at the end of 2016.⁸ U.S. officials argued in the other cases, such as a credit for investments in clean coal facilities, that such policies do not increase fossil fuel combustion and are meant to reduce environmental impacts so they should not be considered inefficient subsidies.

One practice that the United States ought to have included in the peer review process is its subsidization of coal production on federal lands.⁹ These policies include the U.S. Department of the Interior’s undervaluation and sale of coal at below-market prices, subsidies for the transport and washing of coal, and subsidies that promote the mining of coal that otherwise would be economically unviable.¹⁰ To its credit, the Obama administration has launched a comprehensive review of the federal coal leasing program and temporarily suspended the issuance of new leases in the meantime.¹¹ However, because the fossil fuel subsidies self-report was completed in 2015, just before the announcement of this federal review process, the United States missed the opportunity to highlight some more recent positive steps that it is taking to address subsidies.¹²

While the Obama administration made a commitment to phase out all of its inefficient fossil fuel subsidies by 2025, most of these subsidies require Congress to eliminate them. Congress, however, has consistently refused to act.¹³ In light of this political reality, reviewers recommended that the administration undertake a more robust communication strategy to increase political pressure on opponents of reform.

China

The Chinese government deserves credit for making a good faith effort to make full use of the peer review process to identify where its fossil fuel subsidies exist, as well as to better understand gaps in its knowledge about the scale and scope of such subsidies. The final peer review report identified fossil fuel subsidies in sectors ranging from upstream production and refining to power and heat generation to downstream commercial and residential end use. These sectors include policies that exempt the China National Petroleum Corporation and China National Offshore Oil Corporation—which are both state-owned entities—from land-use taxes; exempt thermal power stations from land-use taxes in cities and towns; and provide preferential tax rates for fossil fuel used in the residential and commercial sectors. The largest quantified subsidy, costing \$15 billion annually, was for transportation fuels for “professional fuel users,” including fishermen, foresters, taxi drivers, and public transit companies. The smallest quantified, at \$20 million annually, was a consumption tax exemption for oil used by refined oil manufacturing enterprises.¹⁴

The report also surfaced some commendable progress that is underway. For instance, China has begun to reform its oil market to allow prices to more closely fluctuate with the international market. In addition, China has established a price floor for oil, with the difference when prices drop below \$40 per barrel directed to cleaner alternatives, such as energy efficiency, or to be used as a buffer for future price fluctuations. While oil prices have been above this threshold recently, prices were below \$40 per barrel in January 2016, suggesting that this policy has been utilized.¹⁵

Despite this progress, there is still much more work to be done—both in terms of identifying the subsidies and then addressing them. The Chinese themselves recognize that they have significant blind spots. For instance, reviewers noted that Chinese officials might be able to locate—and, in turn, address—additional subsidies by examining “preferential loans, loan guarantees, support of a regulatory nature, and the support provided at the provincial level.”¹⁶

Moreover, the Chinese officials admitted they were unable even to estimate the cost of six of the nine subsidies that they identified. Frequently, officials cited the challenges posed by missing data and evolving policies. For example, many of the identified subsidies related to real estate, land-use, and urban tax exemptions for fossil fuel entities lacked cost estimates due to gaps in provincial and city-level implementation data. Additionally, there are other subsidies—such as the preferential value-added tax for fossil fuels used in the residential sector—that could use further data to assess their effectiveness in realizing their intended goals—in this example, the expansion of energy access to low-income households.¹⁷

That said, identifying such gaps in a country’s understanding of where subsidies exist and how much they are costing is a key purpose and value of such peer reviews. It is encouraging that Chinese officials appeared to be engaged in a good faith effort to disclose—rather than minimize or dismiss—the potential significance of such blind spots in their subsidy practices.

Moving forward

The results of this initial peer review represent a step in the right direction; however, current and future participants of this process must take additional actions in order to build on this framework.

It is important that these peer reviews are not the end of the subsidy review process for the participating countries. Based on the findings from the review of Chinese fossil fuel subsidies, it is clear that more work is underway to reform these programs and the broader natural resource policies in the country. In order to continue to support these efforts and similar reforms identified in other peer reviewed countries, the G-20 should create a process by which participants agree to report back on future progress and a system by which country commitments can be tracked. This would help ensure that the important insights gained from the peer review process do not become just an academic exercise.

In order to further facilitate the collaboration and learning that the process of peer reviews can engender, countries that have completed their reviews should also participate in an advisory role in subsequent reviews for other countries. This would allow those countries to share the lessons learned from their own experiences and help guide the process for new participants.

The value of the peer review process should extend beyond identifying data and cost-assessment gaps—as it did in the case of China—to help close those gaps. To that end, participants in this process should share their expertise and experience with one another. For example, the U.S. federal government has significant experience evaluating the impacts of the Low Income Home Energy Assistance Program, or LIHEAP.¹⁸ This methodology could be useful to other countries as they assess their own subsidy programs.

In addition to participant countries supporting future peer reviews, civil society groups and academic institutions should be provided a channel whereby they can provide input into this process at the outset. With their technical expertise and insights, these organizations can further assist countries in identifying and quantifying potential fossil fuel subsidies, thereby enhancing review findings.

Review of the U.S. fossil fuel subsidies show that a major impediment to reform can be a lack of public awareness of the policies and the benefits of reform. While each country has its own unique political institutions and dynamics, future engagement around the peer review process would allow countries seeking reform to share best practices on effective strategies to communicate with the public.

While more work remains to be done to phase out inefficient and environmentally detrimental fossil fuel subsidies, the example set by this first peer review process provides a solid foundation for further peer reviews and can continue to build the drumbeat for further actions.

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Endnotes

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