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Energy and Industrial Competitiveness

**“THE FOSSIL FUEL SUBSIDIES TO THE ENERGY SECTOR
IN ITALY” (*)**

Mario Iannotti

Advisor, Energy Environmental Economist

Italian Ministry of Environment, Land and Sea – Sogesid T.A.
Directorate General Sustainable Development and EU and International Relations

(*) The views expressed in this presentation are of those of the author and should not be reported as or attributed to the Ministry or to the organizations with which he cooperates



Aims of the presentation:

- ✓ to indentify the Fossil Fuel Subsidies (FFSs), in the form of tax expenditures, to the Italian energy sector;
- ✓ to suggest, in line with the recommendations of International Organizations and the Paris Agreement, a reform of the FFSs: removing FFSs progressively and save these economic resources also to increase the competitiveness of the industrial sector.

Outline of the presentation:

1. The definition of the Fossil Fuel Subsidies in the form of tax expenditures
2. The methodology used to identify the FFSs
3. An estimation of the FFSs in the form of tax expenditures to the Italian Energy Sector
4. Conclusions

1. What is a Fossil Fuel Subsidies? - Definition

- ✓ The Organization for Economic Co-operation and Development (OECD) defines a subsidy as “**any measure that keeps prices for consumers below market levels, or for producers above market levels or that reduces costs for consumers or producers**” (OECD, 2005, p.114). The majority of FFSs affect the end user price and the quantity of fossil fuels used, through their impact on the demand and supply of different fossil fuels.

1. What is a Tax expenditures? - Definition

- ✓ The International Monetary Fund (IMF) defines a tax expenditures as “government revenues foregone as a result of differential, or preferential, treatment of specific sectors, activities, regions, or agents. They can take many forms, including **allowances** (deductions from the base), **exemptions** (exclusions from the base), **rate relief** (lower rates), **credits** (reductions in liability) and **tax deferrals** (postponing payments)”.

Source: “*Reforming Tax Expenditures in Italy: What, Why, and How?*” Justin Tyson
WP/14/7 - IMF Working Paper , January 2014.

1. What is a Environmentally Harmful Subsidies (EHS)?

- Huge exemptions delivers large amounts of environmentally harmful subsidies (EHS) based on OECD's definition: *a result of a government action that confers an advantage on consumers and producers in order to supplement their income or lower their costs, but in doing so, discriminates against sound environmental policies* (OECD, 2005).
- Sometimes the evaluation of the environmental impact of a subsidy is complicated to determine. The literature is ample and abundant of contributions.

2. The Methodology

- An estimation of the financial impact of specific subsidy is revealed by the **loss of revenues** to the respective tax authority. The basic assumption is that, when a subsidy is deleted, the contributory behaviour of individuals will remain unchanged;
- the adopted methodology follows the: **COST-RECOVERY PRINCIPLE IN ORDER TO ESTIMATE THE TAX EXPENDITURES TO THE ENERGY SECTOR.** Costs for the generation of electricity by a particular type of fuel such as gas, coal, oil, hydro or renewable are calculated by dividing the total cost of the fuel type by the total amount of electricity generated using that source;
- the economic estimation and financial impact of the tax expenditures have been sourced from the Notes to the Accounts of Central-Government Budget, 2016-18.

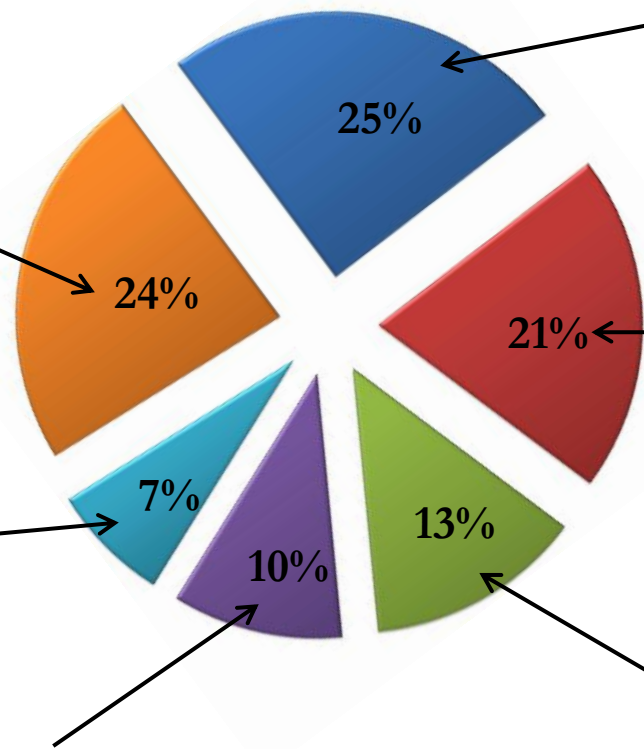
3. Focus on FFSs (Tax expenditures) for the energy sector

- Data from financial reports of Government's general Accounting Department and the Italian Catalogue on environmentally harmful and friendly subsidies show that discounts to excises on energy products in Italy were estimated at 6.4 € billion in 2016, 2017, 2018.

3. Focus on FFSs in the form of Tax expenditures for the energy sector



other items like, the tax relief for the **SERVICE STATIONS** or the exemption from excise duty on electricity used in **RESIDENTIAL HOMES** (ca. € bn 1.4)



fuel for the purpose of **AIR NAVIGATION**
(ca. € bn 1.5)



fuel for **ROAD TRANSPORT (DIESEL)**
(ca. € bn 1.3)

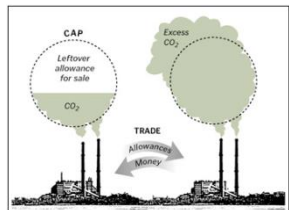


fuel for **NAVIGATION** in Community Marine Waters (including fishing), fuel for **NAVIGATION IN INLAND WATERS**,
(ca. € mn 450)

use of energy products in **AGRICULTURE AND SIMILAR WORKS**
(ca. € mn 830)



free allocation of CO₂ **EMISSIONS TRADING ALLOWANCES**
(ca. € mn 654)



- according to Paris Agreement (paragraph 136 of the 1/CP.21 Decision) it is necessary “*providing incentives for emission reduction activities*” in order to “*limit the temperature increase to 1.5°C above preindustrial levels*” by the end of century (article 2 of the Agreement);
- follow the recommendations of the IGOs (OECD, IMF, WB, G20, UNEP, FAO, EEA, IEA) and include in the definition of subsidies the external costs of economic activities (cfr. IMF 2014).

4. Conclusions

The analysis and the quantification of the implicit subsidies would require a special national monitoring mechanism of the external costs of economic activities, which is currently not available and could be prepared in the near future.

The IMF reveals that “*energy subsidies are very large; their removal would generate very substantial environmental revenue and welfare gains; and their reform should be implemented immediately, albeit gradually, given the uncertainty over the precise level of energy taxes required*”. (Coady et al., 2015a)

4. Conclusions (1)

Hence, it is recommended to:

- a) improve the knowledge base in support of spatial impact assessment of each type of aid including, direct subsidies, tax breaks and implicit subsidies associated with the incomplete application of the Polluter Pays Principle;

applying PPP to allocate the costs of pollution prevention that encourages rational use of scarce resources and avoids distortion in international trade and investment.

4. Conclusions (2)

b) FFSs expenditures amount to about 6.4 €billion for 2016, 2017 and 2018. These amounts should be cut progressively and could be used for one of the following targets (or a mix of them):

1. the reduction of income taxation, in particular on jobs generated by green economy;
2. innovation and diffusion of low-carbon technologies and products;
3. financing of sustainable patterns of production and consumption;
4. the revision of the financing of energy production subsidies from renewable sources;
5. increased financing of energy efficiency measures;
6. the reduction of accumulated public debt.

Thanks for the attention!

marioiannotti@gmail.com

THE CHANGE IS THE ONLY CONSTANT

