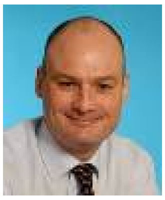
The Government's financial support for fossil fuel companies is being overlooked

Bob Ward explores the subsidies currently doled out by the government to fossil fuel companies and asks why it has not attracted the same degree of criticism as subsidies for the renewable energy industry.



The new Energy Bill, which was introduced into Parliament on 29 November, has provoked some criticism for laying out plans to subsidise renewable power up to 2020, but has elicited little comment about its silence over the massive financial support that the Government continues to provide to fossil fuel companies.

An analysis published last year by the Organisation for Economic Cooperation and Development and International Energy Agency found that gas, oil and coal companies in the UK have been receiving more than £3 billion a year in the form of tax breaks and other incentives for production and consumption.

The analysis provides "estimates of direct budgetary support and tax expenditures supporting the production or consumption of fossil fuels". It states:

> *"The scope of what is considered 'support' is here deliberately broad, and is broader than some conceptions of 'subsidy'. Essentially, it includes both direct budgetary expenditures and tax expenditures that in some way provide a benefit or preference for fossil-fuel production or consumption relative to alternatives."*

The largest part of the UK Government's hand-out to the fossil fuel industries is the reduced rate of VAT on the consumption of electricity and heating, most of which is supplied by burning fossil fuels. In addition, the lack of a strong carbon price across the economy means that fossil fuels enjoy a huge implicit subsidy because they do not bear the costs of the climate change impacts that result from the greenhouse gas pollution. When it comes to fossil fuels, the polluter does not pay.

Despite the severe pressures on the public purse, fossil fuel interests are set to benefit even more from the Government's largesse in the future. In the Budget in March 2012, the Chancellor announced an increase in the size and eligibility of allowances for small oil and gas fields in the North Sea, and a new £3 billion allowance for drilling to the west of the Shetland Isles (see pages 12-13 here). And during his speech at the Conservative Party conference in October 2012, Mr Osborne promised companies "a generous new tax regime" to encourage the search for shale gas reserves.

What is perhaps even more remarkable is that the Chancellor in November 2012 signed a communiqué in Mexico City, alongside other G20 finance ministers, which promised to "rationalize and phase-out over the medium-term inefficient fossil fuel subsidies that encourage wasteful consumption". This was a renewal of a pledge made by G20 leaders at their summit in Pittsburgh in September 2009, which acknowledged that "inefficient fossil fuel subsidies encourage wasteful consumption, distort markets, impede investment in clean energy sources and undermine efforts to deal with climate change".

Yet the 'World Energy Outlook 2012' report, published in November 2012 by the International Energy Agency, points out that subsidies and other Government financial support for the fossil fuel industries reached near-record levels in 2011. Subsidies for the consumption of fossil fuels amounted to $523 billion (£330 billion) last year, up 28 per cent from $409 billion (£258 billion) in 2010. After a major dip in 2009 during the economic downturn, Government subsidies for the consumption of fossil fuels are approaching the peak level of 2008.

When one adds support for production and general services, governments and taxpayers worldwide gifted the fossil fuel industries more than half a trillion pounds last year through direct subsidies and other forms of spending and tax breaks. With all this public money being handed over to the private sector, one might have discussions about UK energy policy to include plans for how the Government to keep its G20 pledge on fossil fuels. Yet bizarrely, political and media attention is focused on Government support for alternative sources of energy that would reduce the UK's dependence on oil, coal and gas.

In the UK, renewables, including hydro, are expected to receive just over £1 billion, of which less than half went to onshore wind, in direct subsidies in 2011-12 through feed-in tariffs and the Renewables Obligation. Globally, the International Energy Agency found that consumption subsidies for renewable energy in 2011 were $88 billion (£56 billion), about one-sixth of the equivalent help for fossil fuels.

But the case for Government support for relatively new renewable technologies is far clearer than it is for established fossil fuels, as Nicholas Stern pointed out in an article in 'The Observer' in November 2012. Subsidies help to correct market failures that hold back the rapid development of renewables, and to create a level playing field with fossil fuels. Such failures include the inability of capital markets to manage properly the risks associated with investments in new technologies. And other failures are associated with the limitations of networks to accommodate new technologies, particularly public transport and power grids.

However, such subsidies for renewable technologies should be reduced and eliminated as the costs of development and deployment fall over time, as carbon markets become stronger and as other market failures are tackled. Onshore wind energy is expected to become economically competitive with gas-fired power stations as a source of electricity generation within the next 5-10 years, and the subsidy for onshore wind farms through the Renewables Obligation was reduced by 10 per cent earlier this year in recognition of recent cost reductions.

But such sound economic reasoning does not, apparently, apply to fossil fuels, which are likely to remain hooked on UK Government financial support for the foreseeable future, unless and until the Chancellor and the rest of the Government decide to keep the G20 pledge.

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