

## NAO Estonia: Environmentally harmful subsidies – relation to resilience and climate change adaptation

Estonian government has evaluated potential impacts of climate change and has adopted a Climate Change Adaptation Development Plan.<sup>1</sup> Although climate change in Estonia is not as extreme as in many other countries of the world, based on forecasts, we can expect the following changes during the 21st century:

- rise in temperature
- increase in the amount of precipitation, especially in winter periods
- rise in sea level and the related shore erosion
- increase in the number of storms.

NAO Estonia has approached the topic of climate change resilience and adaptation in several audits. For example, in the audit report on land improvement systems<sup>2</sup> we pointed out that rehabilitation of land improvement systems in areas with peat soils should not be executed because this will cause the emission of greenhouse gases. By stopping the drainage of these areas and turning them into permanent grasslands would help to reduce greenhouse gas emissions, but in addition would restore water regime and create water buffer areas which help to mitigate negative effects of increasing precipitation.

It is important to understand which kind of measures the government is using to achieve its environmental objectives, incl. related to climate change adaptation. But also *vice versa* – which are the existing measures which do not support the achievement of environment and climate objectives, are contradictory and even pose negative impact on the environment.

Therefore, NAOE conducted a review on identifying and phasing out **environmentally harmful subsidies** in Estonia.<sup>3</sup> The review describes the nature of environmentally harmful subsidies, activities taken by EU countries and international organisations to find out and evaluate them and examples of existing subsidies. Harmful impact of subsidies can occur to various environmental aspects: climate, water, biological diversity etc. There are also subsidies which work against climate resilience and climate change adaptation. For instance, there are subsidies which encourage water use (e.g. in agriculture), subsidies for rehabilitation of land improvement systems, forest clear cutting practices.

### Environmentally harmful subsidies – definition

Environmentally harmful subsidies are the subsidies for which the public sector does not receive remuneration and that provide an advantage to certain consumers, users or manufacturers as additional income or reduction of costs, but that also have an adverse environmental impact which would not have arisen without this subsidy.

#### In-budget subsidies

- direct transfer of funds to producers and consumers (e.g. capital grants, income support, low interest loans)
- potential direct transfers of funds (e.g. covering accident liabilities of oil spills)
- provision of general infrastructure (e.g. motorways);
- below-cost fees for government-provided infrastructure and services

#### Off-budget subsidies

- Government revenues due are foregone or not collected (e.g. tax credits) e.g. from excise duty for fuels, favourable tax treatment of company cars
- Tax concessions (exemptions, allowances, credits, rate relief, tax deferral)
- Debt concessions (write-offs and rescheduling)
- Market-price guarantees (e.g. fixed prices, premiums or bonuses), preferential market access
- Income or price support (e.g. production quotas, feed-in tariffs)
- Below-market interest rates
- Lack of charging for external costs of activity or resource use;

<sup>1</sup> Estonian Ministry of the Environment, 2017. [Climate Change Adaptation Development Plan until 2030](#).

<sup>2</sup> NAOE, 2020. [Sustainability of measures for rehabilitating land improvement systems](#) (summary in English)

<sup>3</sup> NAOE, 2022. [Environmentally harmful subsidies](#) (report in English)

The report emphasised that it is important to evaluate the various environmental and socio-economic impacts of the subsidies. There is a good example from the European Commission who has established [Do No Significant Harm principles](#) when they assess Recovery and Resilience Plans submitted from member states. These principles and assessment must ensure that no measure should lead to significant harm to *six* environmental objectives. *Climate change adaptation* is one of those objectives. There is also the [European Green Taxonomy](#) initiative which help to bring environmental aspects into decision making process. In nutshell these processes try to bring message that environmental impact must be assessed and considered when substantial financial decisions are being made, whether it is drafting a state budget or making decision on investment projects.

As the Estonian government had not identified systematically, unlike many other countries, environmentally harmful subsidies NAOE recommended to designate a responsible governmental authority and identify and analyse all subsidies with adverse environmental impact comprehensively by using existing international methodologies. After doing so it becomes clear which subsidies are easier to phase out. Priority should be given to the abolition of environmentally harmful subsidies that are socio-economically acceptable, the abolition of which is not opposed, and the abolition of which has a positive impact on both the environment and the budget. See the figure.

*Figure: Scheme for the identification, assessment and phasing out of environmentally harmful subsidies*

