

Environmentally harmful subsidies

*How has the impact of environmentally harmful
subsidies been assessed and what has prevented
abolishing them?*

Dear readers,

Russia's war against Ukraine which began in the morning of February 24 has put Estonia in a completely new situation, in almost every area of life.

The development goals set by Estonia in the areas of social protection, economy, environment and many other areas continue to be relevant, but the impact of Russia's military actions means that the journey to achieving the objectives may be more complicated than previously thought. The new context does not necessarily mean abandoning the end goals and deadlines, but it does mean a plan that takes the circumstances into account to achieve those goals.

The situation in the field of environmental protection and energy is also new. It is clear that we need the results of the green revolution, particularly the reduction of dependence on oil and gas, more than ever before. Because oil and gas tend to come from a country whose budget we do not want to fill. On the other hand, it cannot be ruled out that measures that did not fit into action plans before the war will have to be implemented in the coming years. We need to differentiate between the long term and what happens in a year, two or three.

Energy independence is emerging for achieving which in the short term there is no environmentally friendly solution, but which is also one of the long-term goals of the green revolution. True, we are still a long way away from ensuring energy independence with wind and solar energy. Achieving this in the winter months would require a major leap in production capacity and storage capacity, but this breakthrough is more of a long-term matter.

Rather, certain setbacks can be expected as some EU states had planned to rely on Russian gas in the transition to the green revolution. Both the shortage of gas in the summer and autumn of 2021 as well as the Russia-Ukraine war that began this winter that exacerbates the shortage even more mean that the shortage of gas is hoped to be overcome by increasing the use of coal in place of gas. In Estonia, it was planned to stop the production of oil shale electricity by 2035, but at the same time, the intention is to maintain the production capacity and the state is prepared to pay for it.

Sometimes you have to take a step back to take several steps forward later. The question is, however, whether we allow the temporary to become permanent. If that happens, we might discover again at one point, just like this autumn with the dizzying increase in electricity prices, that time has been wasted but despite all the warnings, we are not ready to adapt to the changing world. The slow construction of Estonian wind farms is a sad example of ignoring the warnings.

The state and private enterprises have already made and will continue to make significant investments to achieve the environmental objectives. At the same time, we might find ourselves in a situation where the state provides funds for the prevention, mitigation or elimination of environmental issues with one hand but contributes to the burden on the environment with the other hand through various support schemes, tax differences, incentives and other similar measures.

Many states have identified economic measures with significant adverse environmental impact, on the one hand to avoid measures with the opposite effect and, on the other hand, to gradually phase out subsidies that have a significant impact on the environment. The gradual phasing out of such subsidies must also, of course, take into account that in addition to environmental objectives, the state must also take account of socio-economic objectives. But there is nothing that prevents taking the first step – identifying the economic measures with a significant environmental impact and analysing their impact in the subsequent development of economic measures to avoid the establishment of new subsidies that have an undesirable impact on the environment.



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Summary of the results of the overview

Problem to be solved

Many support schemes, tax differences, incentives and other economic measures in force in Estonia run counter to the state's own environmental objectives and may also be economically inefficient.

The state should not contribute to pollution, more intensive use and waste of resources (e.g. mineral resources, water, energy, products and services), loss of habitats, etc.

Main conclusion of the overview

Environmentally harmful subsidies have not been identified in Estonia, nor has their impact been assessed. There is also no aim set to amend or gradually phase out those measures.

Environmentally harmful subsidies send signals to the public and the private sector to act and make investments that run counter to the environmental objectives set by the government. In most cases, these subsidies are incompatible with the principle that the polluter pays, encourage dependence on state support and that some products or services offered are not economically sustainable.

On the one hand, harmful subsidies contribute to the burden on the environment, and, on the other hand, the state has to spend money to mitigate and eliminate these impacts. For example, the state has supported depositing waste in a hazardous waste landfill in such a way that the ad-hoc fee collected from entities landfilling waste to close the landfill does not cover all the costs of covering the landfill and the state has also had to use taxpayers' money. Taxpayers' money has had to be used to also eliminate environmental pollution caused by incompetent management.

Elsewhere in the world, environmentally harmful subsidies are the most prevalent in the energy, transport, and agriculture sectors. In recent years, a number of tax and fee differences have been added in Estonia and individual decisions have been made that may be considered to be environmentally harmful based on the experience of other states. For example, these may be support for renewable energy for burning wood in an oil shale power plant, various incentives for enterprises with high energy consumption, establishment of an oil shale plant. A number of decisions have also been made during the Covid-19 crisis which clearly show signs of being environmentally harmful subsidies, such as lowering excise duty on fuel and the fee for depositing oil shale ash.

There are no obstacles to identifying and assessing environmentally harmful subsidies, but there are circumstances in amending and abolishing them that must be acknowledged before taking action. These are mainly other – socio-economic – objectives and the complexity of assessing the impact and effectiveness thereof, lack of (political) priority, opposition by stakeholders, etc.

There is no clear goal in Estonian strategic documents and laws to identify and abolish environmentally harmful subsidies. At the same time, this is not in conflict with the objectives of development plans. Identifying and abolishing environmentally harmful subsidies does not require a reorganisation of the work of authorities but a more precise targeting of activities, reviewing of priorities and a more thorough assessment of the existing and future economic measures.

Environmentally harmful subsidies are the activities/support without reciprocity from the public sector that provide an advantage to certain consumers, users or manufacturers as additional income or reduction of costs but that have an adverse environmental impact (foremost due to increased production and consumption which would not have come about without the state's support).

The amount of environmentally harmful subsidies can be considerable, for example Finnish tax differences related to transport and energy that are considered to be environmentally harmful total 3.2 billion euros. Finnish state budget for 2020 was 62 billion euros.

Obstacles

Necessary steps

In order to use state funds wisely, without compromising environmental objectives and, at the same time, with socio-economic objectives in mind, the following steps should be taken:

- **Designate a responsible governmental authority and identify all economic measures with adverse environmental impact comprehensively and in the area of responsibility of all ministries.** The identification of environmentally harmful measures provides a basis for a more thorough assessment of economic measures with a more significant environmental impact and for mitigating their impact or gradually phasing them out.
- **Use existing international methodologies for identifying and assessing environmentally harmful subsidies by adapting them to the needs of Estonia.** At first prepare so-called ID-cards for the identified subsidies in which the impact caused by them and the ability to reform them is assessed.
- **Analyse the environmental impact of economic measures in developing them and avoid establishing new environmentally harmful subsidies.** The current impact assessment of draft legislation and development plans is not thorough enough to help identify environmentally harmful subsidies. It is important that the assessment of environmentally harmful subsidies is a regular action rooted in practice.
- **After identifying and assessing environmentally harmful subsidies more thoroughly, it becomes clear which subsidies are easier to abolish.** 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.

Purpose of the changes

The purpose of identifying environmentally harmful subsidies and assessing their impact is to identify all potential environmentally harmful subsidies and, as the first priority, abolish those that have a significant adverse environmental impact and that are ineffective, i.e. that do not meet their original objective or that have more effective alternatives. The aim is also to avoid establishing new subsidies that could potentially be environmentally harmful.

Responses of the auditees

The auditees find that addressing the topic of environmentally harmful subsidies is necessary and it needs to be addressed further. In a situation of limited public funds, it is important to comprehensively assess whether the state has subsidies that are environmentally harmful and that cause additional costs to society. Several auditees are of the opinion that a clear government mandate and coordination across governmental authorities is needed to identify environmentally harmful subsidies and assess their impact. It is also important to agree on common criteria and methodology for assessing environmentally harmful subsidies.

The auditees emphasised that in addition to environmental objectives, the achievement of other objectives of the state must also be taken into account when it comes to environmentally harmful subsidies. The abolition of subsidies may be justified in the long run, but they should be maintained in the shorter term in the absence of more environmentally friendly alternatives. It was also pointed out that several support measures

are valid throughout the European Union and it is either not possible or not reasonable for Estonia to abolish them unilaterally.

Several auditees indicated that efforts are already being made at both the European Union and the Estonian level to assess the environmental impact of subsidies and to determine the purposefulness of the measures. For example, the new common agricultural policy of the European Union and its subsidies have greater environmental ambition. The European Union has also shown that all state support and investments must take environmental issues into account and that activities with an adverse impact on the environment are not acceptable.

Both the Ministry of the Environment and Statistics Estonia are prepared to contribute to the project of identifying and assessing environmentally harmful subsidies.