

Chair's Summary

Lori Ridgeway

Chair of the OECD Committee on Fisheries

Introduction

I was pleased to Chair this interesting workshop as an ongoing part of the OECD cross-cutting project on reforming environmentally harmful subsidies, under the auspices of the OECD Annual Meeting of Sustainable Development Experts (AMSDE). This workshop focused – as the third in a series of workshops on subsidy reform – on the political economy of reforming environmentally harmful subsidies. This was a workshop in which we moved beyond the technical aspects of the implications of certain kinds of subsidies on the environment, to instead discuss the difficult issue of how to implement reform of these subsidies, *i.e.* moving from the “what” to the “how”.

In addition to both a contextual review of frameworks for assessing subsidies and a closing panel discussion, seven case studies were considered, covering aspects of subsidies related to agriculture, fisheries, coal, enterprise zones and transportation. These sectors were well chosen for this workshop, as subsidies in these same sectors have already been considered in previous sessions in terms of the nature of their linkages to the environment, as well as the application of a “checklist approach” to evaluating the role of subsidies in these sectors’ policy tool-kits. This analysis is well outlined in *Environmentally Harmful Subsidies: Challenges for Reform* (OECD, 2005), which shows that the potential benefits from subsidy reform in these sectors are large.

The context for this workshop was well set by that Report. In addition to showing that there is a considerable way to go in reforming these subsidies, it notes the following:

“...The removal of [such] harmful subsidies therefore offers the tantalizing prospect of a “win-win” situation, both for the economy and the environment. Yet governments around the world have been reluctant to dismantle perverse subsidies, despite growing environmental awareness and pressures on government budgets...”
(p.113)

In other words, we continue to live in a seeming “lose-lose” situation, in these contexts at least. It is clear there are opportunities for action, but there are clearly political and economic impediments to overcome in implementing subsidy reform. Since government policies are ultimately a consequence of political choices, it is necessary to examine the political incentives and motives of policy makers, which was the topic of this workshop.

The very nature of underlying decision-making contexts, institutions and especially political contexts is, by nature, situation-specific. The challenge for this workshop was to

step back and understand lessons that are transferable to other reform situations, and to help plan future OECD discussions on this topic.

Among many issues, key questions that were relevant to the workshop included:

- the original motivation for the existing subsidies (in other words, the “stakes” at play);
- the motivation for change (whether these be crisis, opportunistic reform, the results of a rational diagnostic, internal pressure for reform, external pressure for reform);
- the key players and potential “gainers” and “losers” from reform;
- the key opportunities, synergies or alliances that helped the momentum for reform;
- the nature of the key obstacles;
- strategies and or tactics that maximised synergies or overcame obstacles (including neutralising “rent-seeking” behaviour by affected interests that prevent reforms from being implemented);
- the nature of governance issues (how interests were accommodated in the decision-making);
- the role of information and transparency;
- whether reform was an isolated event or part of a broader reform effort;
- transition issues, tools and policies;
- ultimate impacts in a sustainable development context; and
- the lessons learned (what would change if one had to make the same reform again?).

Context-setting presentations presented by Anthony Cox, OECD Directorate for Food, Agriculture and Fisheries (*Overview of Approaches for Assessing Subsidies*) and Maja Larsson, Sweden (*Accounting Approaches for Assessing Subsidies and Taxes*) provided a lively start to the workshop by showing that there is room to break new ground in data and analytical methods on a parallel track to understanding the practical issues of reform.

Even though the Cox paper provided a practical tool for subsidies evaluation, which contrasted with the formal accounting-based approach presented by Larsson, each aimed at a different aspect of the subsidies issue, they both emphasized the interdisciplinary nature of the reform issue and the need to continue to share experiences and best practices. Discussion of these two presentations opened several aspects of debate that were to arise throughout the sessions: 1) the extent to which subsidy reform is dependent – or not – on a common definition and methodology for measuring subsidies; 2) the role and assessment of environmentally-motivated subsidies; and 3) how to account for the role of “policy filters” (terminology from the checklist approach that refers to offsetting policies and management that can alter the effect of subsidies on the environment). The checklist approach shows that these are critical to understanding and evaluating the role and impact of subsidies, whereas modelling and accounting approaches make it difficult to take such impacts into account when calculating impacts. This shows that there is a

need for complementary analyses in fully understanding and evaluating the impact of subsidies on the economy and environment.

The sessions on case studies featured four presentations in the agriculture and fisheries sectors: Vangelis Vitalis, New Zealand (*Subsidy Reform in the New Zealand Agriculture Sector*), Roland Pittar, Australia (*Water Reform and the Agriculture Sector in Australia*), Jan-Frederik Danielson, Norway (*Subsidy Reform in the Norwegian Fisheries Sector*), and Gorazd Ruseski, Canada (*Subsidies and the 2003 Cod Fisheries Closures in Canada*). The fisheries and agriculture sectors are areas where there is a presumption of significant direct environmental gain from subsidy reform, and also where both sectors have visible and powerful vested interests, not the least because of implications for rural livelihoods where there are often few alternatives. The Ruseski paper differed from the others in terms of its having demonstrated a choice not to use a transitional subsidy to assist structural reform, in contrast to the past, whereas the others cases featured reforms of existing subsidies.

The other case studies featured a more regional-, sectoral- or geographically-motivated set of issues, including industrial subsidies intended to promote economic development, and highlighting, in these cases, the environmental externalities of subsidy-induced production or activities: Miroslav Hajek, Czech Republic (*Reform of Enterprise Zone Subsidies in the Czech Republic*), and Peter Franz and Harald Neitzel, Germany (*Reform of Hard Coal Subsidies in Germany*). In addition, another case study by Karl Steininger and Franz Prettenthaler, Austria (*Reforming Counterproductive Subsidies an Austrian Transport*) also focussed on the externalities of various pricing and subsidy choices in transportation intended to affect – or offset – location decisions. Both the Steininger/Prettenthaler and Hajek papers differed from all the others in terms of being *proactive* evaluations of the need for subsidy reform for environmental purposes (which had not yet, however, taken place) driven directly or indirectly by environment departments. The political economy issues in these cases would be the extent to which these review efforts would result in future reforms – a question that can be revisited in the future.

A panel discussion of participants from the intergovernmental and non-governmental organisation (NGO) communities – Dave Boyer (International Institute for Sustainable Development), Mark Radka (UNEP), Mathias Seiche (Friends of the Earth) and Scott Vaughan (OAS) – ended the workshop with an equally lively and valuable debate.

Considerations from the Case Studies

Prior to outlining generic lessons and issues from the broad discussions in the workshop, this section outlines some broad similarities and differences in the case studies themselves, which shows considerations that future reform exercises may wish to exploit (and which future workshops may wish to examine further). These cases show that reform strategies and tactics are context specific, but that some general conclusions can be drawn or further investigated.

Motivations for the original subsidies varied across the case studies but mainly focused on: 1) regional and sectoral promotion and development and job creation (including, in one case, the use of windfall government revenues); 2) an attempt to overcome market failures in the provision of infrastructure; and 3) past attempts to ease the transition of structural reform. In several cases, the subsidies were originally thought to be short term, but became instead imbedded in the sector and in expectations. Often

subsidies were embedded in a more general set of “preferences” enabled by government policy or programmes favouring the affected sectors, a factor that may not yet have been emphasized in the work on subsidies reform, and which thus might overstate the environmental benefits of subsidy reform alone when induced environmental harm is correlated with the entire cluster of preferences.

The *motivations for subsidies reform* also varied somewhat across the cases discussed. As noted above, only two demonstrated a potential future reform based on current *proactive* analysis (led or contracted by government environmental interests). These efforts may result in subsidy reform in the future if taken up more broadly in government processes. Other case studies were examples of *ex post* analysis, where motivation for reform was most often a combination of some external crises (fiscal and economic, climate or resource). In most cases, the subsidy reform was part of a more general reform of policies and approaches, sometimes aided by a change in political orientation. Only in rare cases, at least as described in the workshop, were environmental issues a direct *driving* motivation for reform, although environmental impacts did figure in some problem definitions in the case studies. While leverage from multilateral processes and rules were cited as a potential motivator for subsidies reform, they did not play a large role in the cases described in this workshop, but were described as possible consideration for the future.

Synergies and opportunities that could be exploited certainly did help the momentum for reform in several cases, showing the broader potential role for opportunistic reform. Sometimes these included stakeholder groups – such as well-performing segments of sectors or regions – that could be used to help offset other lobby efforts, including through direct appeal into the political system (for instance, on grounds of equity). In some cases, political or other events allowed an alignment of stakeholder interest that had otherwise been elusive. Generally the bigger the reform effort – breadth and depth – the easier it was to achieve narrower targeted subsidy reform efforts, especially if stakeholders across diverse sectors were being similarly affected. The case of New Zealand is often cited in this respect, as it was in this workshop. In this case, the very crisis that induced the reform was seen as an opportunity, as it allowed a bigger-bang approach than might otherwise have been politically feasible. The subsidy reforms that were embedded in broader reforms also benefited from an alignment of agendas that help overcome impediments – and included modernized policy frameworks that attacked incoherent preferences more holistically.

There were a number of common *obstacles to reform* highlighted by the case studies. Not surprisingly, lobbying interests with strong links into the political system (traditional rent-seeking behaviour) had to be overcome. Anxiety over the social consequences and dislocation from reform of subsidies programmes was an early impediment. Presenters of several case studies argued that “myths” surrounding either the need for subsidies or the costs of reform were an obstacle, and just as interestingly, on the other side of the coin, others said that a lack of a well-understood “justification” for reform was an impediment (presumably relating to a lack of understanding of either costs of subsidies or benefits of reform). The two “proactive” case studies referred to a lack of rigorous analysis and decision-making around the provision of new subsidies for regional or sectoral development – especially in accounting for negative environmental impacts – as playing a role in their proliferation. In some cases, especially where subsidies reduction or elimination (or avoidance) was part of a broader policy reform, new approaches or tools needed to be developed. Issues of economic security and sovereignty – sometimes of the highest political order – were also sometimes at play. The nature of these and other

obstacles provides considerable food for thought on subsidy reform – which was barely scratched in this workshop.

Strategies to overcoming obstacles to subsidy reform focussed on some key common themes. Key among these was the need for high-level political support if not, more often, political leadership. External pressure and especially fiscal and economic crises that helped limit options that allowed accelerated progress also played a key role in a few cases. This highlighted the helpful role that can be played by some central government agencies such as Treasury/Finance departments as agents forcing change. However, in other cases, a gradual approach was viewed as the critical success factor. Whole-of-government partnerships were instrumental in most cases, generally enabling whole-of-sector approaches to reform of preferences in cases where multiple jurisdictions have a role in different aspects of sectoral performance. In all *ex post* case studies, partnerships at the government level and with affected stakeholders – especially dissenters – played a large role, including in some cases, at the problem diagnostic and analysis phase. Timing issues also played a role, with emphasis placed on timing that would allow subsidy reform to take place in an economically advantageous phase in business or sectoral cycles (indicating a role for proactive analysis). Proper sequencing of reforms was also cited as an important lesson learned, especially to enable easier transition (such as trade liberalisation to better enable sectoral recovery and growth expected from subsidy removal; however, it was also noted that the downside of perfect sequencing is delayed reform).

Interestingly, as is clear from the above, *complementary measures* to subsidy reform played a large role in all cases where reforms had taken place, ultimately resulting in a substantially reformed overall policy mix. This included, on one hand, accompanying tariff reduction and trade liberalisation, pricing reform and broader structural reforms that favoured the increased role for market signals and alternate sources of production, and on the public sector management side, complementary management measures, new policy and management frameworks and new planning frameworks accompanied reforms. Rarely if ever was subsidy reform in these cases taken in isolation. Again, this suggests whole-of-government approaches.

In terms of *vested interests*, the cases were weaker in describing these than might have been expected, and thus there was less discussion of *tactics* for overcoming them than might have been hoped. This may have been due to the written nature of the cases in the face of sensitive information, but discussion did not reveal considerable additional information. The generic role of strong political leadership was clearly most poignant here but studies did not directly address *how* this was applied. To some degree these issues are covered above, but there is also room for future workshops to further investigate this issue. Reading between the lines of issues, where difficult interests were private stakeholders, partnerships were used to co-opt them in decision making, as was the mobilization of counter-interests. The issues were a bit more difficult where vested interests were political. Strong fiscal departments were seen by some as a helpful force in removing options in such cases. The most intractable case is when issues of national and economic security are at stake and the issues are of the highest political order with voters. Related to this issue of entrenched interests was the reminder that short-term subsidies can quickly become permanent subsidies, as subsidies become imbedded in planning and expectations, prices (including of capital), resource allocation, and communities' assets, creating vested interests where none had existed before.

Governance is a subject ripe for future workshops, as it is the decision-making process that will determine the success of reform intentions. Partnerships and joint decision-making were integral to all reform efforts, whether intra- or inter-governmental, partnerships with affected sectors, and with a critical role for public consultation. Several cases pointed to a role for strong leadership, not only at the political – but the bureaucratic – level. The latter was seen to be critical where intra-governmental interests had to be brought together and individual ministries may not have had sufficient convening power. This is further complicated when inter-governmental processes need to be brought together. As well, several cases showed an important role for *ex post* evaluation and audit in ongoing planning and decision-making processes. The checklist approach also assumes such adaptive management, and ideally would include evaluation of governance structures themselves in having led to efficient reform processes.

Case studies showed little discussion of *transition measures* and transition planning. One case study, however, examined explicitly the issue of avoiding transition subsidies, due to a combination of *ex post* evaluation that had shown them to be ineffective in the past, and due to the risk of making transition assistance appear as a broad-based entitlement in the face of future possible structural reforms. A broader tool kit of economic diversification was preferred. In other cases, fiscal crisis prevented their consideration. It was generally acknowledged, however, that it is unrealistic to assume that one can avoid all transition assistance, and some modest assistance (debt relief) was put in place even in the biggest-bang approaches. The issue with transition subsidies is, however, the trade off with the pace of reform, as even transitional assistance can affect adaptation to new circumstances, as shown in one of the fisheries case studies.

In all cases, there was a major role to be played by *increased transparency and information* on the amount and costs of subsidies and their impacts. It was seen as critical to offsetting myths, and selling the benefits of reform. An understanding of the actual and opportunity cost-effectiveness of subsidies was seen as critical to building coalitions for reform and neutralizing those more resistant to change. A more difficult debate centered around whether subsidies data needed to be on internationally comparable basis, which is presumably more important, however, when one is relying on external levers such as WTO disciplines rather than other drivers for subsidies reform (see below). However, even national transparency can presumably benefit from some idea of international relativities, although there was no agreement on the importance of comparable data as a prerequisite for reform.

Lastly, in terms of *impacts of reform*, in most cases, economic and environmental benefits from subsidy reform were clear and unequivocally opposite to myths of likely sectoral demise. Economic benefits included fiscal savings, enhanced restructuring, higher post-reform productivity in the affected sectors, increased exports in some cases, increased investment, and increased economic diversification. The profitability of remaining non-subsidized participants increased in case studies examined. Clearly some of these benefits were easier to realize when alternate opportunities were available to those who were displaced in accompanying structural reform, but in no case was the resulting economic result worse than had been forecast, and in virtually all cases – better. As well, market signals were improved, resource allocation more efficient, and in one case “technical lock-in” was also reduced (Australian water dependence in agriculture), leading to more diversification of opportunity and reduced economic risk.

Environmental benefits included both direct and indirect impacts. Environmental benefits – or risks of environmental harm – were direct in the case of primary (agriculture

and fisheries) and other land-intensive activities, and externalities such as pollution have been reduced in other cases. Agricultural subsidy reform benefited pesticide, water and land-use intensity. The risk of over fishing was reduced especially if management regimes were also modified as part of the reform package.

Social impacts were not as straightforward. Short-term community impacts and job losses were unavoidable in some cases, and the most frequently cited concern. In some cases, mitigating policies were of assistance including transitional income assistance, regional development tools and debt forgiveness. Traditional safety nets played a role. However, longer run social benefits of reform were also cited, including increased equity, infrastructure modernisation, reduced dependency and more balanced community growth.

Lessons Emerging from the Workshop

The following overall observations are drawn from the nature of the discussions of the cross-cutting papers, case studies and the panel discussion.

- a) *On the whole it was difficult, in some cases, for workshop participants to stay focused on political economy issues.* It is a difficult debate and raises difficult and sensitive issues. It seemed often that it was easier for participants to return to traditional discussions of the harmful effects of subsidies – the normative aspect of reform – than to debate the practicalities of it. There is work needed, it would appear as well, to help ensure a paradigm under which such issues can be analysed. The issues above were introduced by the Chair on the basis of some logic but were not grounded in any particular or well understood paradigm – especially one that might help ground discussions of solutions and mitigating strategies in the face of rent-seeking behaviour.

In some cases it was made explicit in discussions – sometimes in (exasperated) response to queries of why a simple understanding of the *importance* of reform was not enough to induce it – that issues (especially those of the highest political order) are not necessarily due to a lack of *understanding* of the issues or an *appreciation of the benefits* of reform. Indeed it was noted that the nature of the policy choices may be quite explicitly and transparently debated, and analysis of tradeoffs freely available to the public. Rather, other obstacles may prevent – possibly even permanently – subsidies elimination (even if reduction is possible). In such cases, better targeting of remaining subsidies becomes a premium, and presumably should be, as much as possible, decoupled from environmentally harmful activity. This reinforces the need for future work to stay focused on the political economy of reform in order to understand how to move from intent to implementation, and how to improve the policy effectiveness of regimes when complete reform is not possible.

Part of the reason for this occasional discontinuity in the debate between normative benefits of reform and political economy issues may also have rested in the nature of participation in the workshop. A sharing of experiences on the strategy and especially tactics of reform likely needs exchanges of views among also those who have shepherded reforms through bureaucratic and political decision-making processes – which now calls for experience in policy activities to complement those with technical, environmental or trade expertise. It also may imply a need to change the mix between oral and written aspects of case studies when sensitive aspects such as this are discussed.

- b) The workshop highlighted clearly the importance of the relationship between the political economy of reform and an understanding of environmentally harmful subsidies in the context of all three pillars of a sustainable development. This reflects a maturing of the environmentally harmful subsidies project. It is not sufficient that the issue of subsidies impacts be understood solely by environmental and trade and economic interests. A mainly environmental and economic/trade focus may have been appropriate when trying to understand the economic and environmental impacts and costs of certain kinds of subsidies, and the importance of creating a normative subsidy agenda (which also, one should note, tends to operate in a comparative statics framework). Rational public interest is not, however, always mapped one-to-one into political goals. The political economy of reform focuses on information needed for effective decision-making, and an understanding and overcoming of obstacles to reform including those aspects of reform that play most directly into political agendas, which are heavily affected by social and community outcomes.

Discussions in this workshop confirmed that often *the most difficult aspects of reform related to understanding and handling short-run social impacts of dismantling of subsidies*, and understanding the social costs of inappropriate subsidies (so as to be able to debunk myths, show the benefits of reform and or to manage the impacts and transitions appropriately). The “Checklist approach” may need to move beyond environmental impacts alone to be augmented into a sustainable development framework.

- c) There is a huge role for information, analysis and transparency on the amount, nature and opportunity costs of subsidies as part of reform efforts, in order to tell the story of the benefits of reform, overcome myths and build allies for change. Discussions emphasized the benefits of shared and partnered analysis to build buy-in and ownership to the results and implications. The negative aspects of subsidies removal were, in these case studies, less than feared and the benefits greater. (It was emphasized consistently that the catastrophic predictions of reform opponents were not realized – subsidy reform did not lead to the downfall of the particular industries. There is a need for a sharing of experiences and dissemination of such results). As noted above, however, there is no one preferred type of analysis, and there is a role for both modelling and accounting approaches as well as more practical “current-analytical” approaches to build common understanding.

The case studies showed that the motivations underlying subsidies are generally such (*e.g.*, sectoral promotion, job growth) that preferences can be clustered in a broad range of mutually reinforcing incentives to favour certain sectors, regions or activities. This has numerous implications for this agenda and analysis. First it emphasizes that subsidies removal alone, especially when environmental impacts are induced, may be necessary – but not sufficient – to realize a significant change in sectoral behaviour and thus environmental impact. The link of environmental impact to subsidies removal will necessarily depend on the weight of subsidies in the package of preferences.

- d) The case studies also showed that *subsidy reform did not tend to proceed in isolation of other changes in policy, pricing, and programmes*. Most governments took a holistic approach to the reforms being proposed. This showed up in a broad set of partnerships and alignment of agendas that were mobilized, and

again emphasizes the need for strong political and bureaucratic leadership including among different ministries and orders of government.

- e) Thus effective public governance and policy coherence are both critical aspects of successful environmental outcomes from subsidy reform, and to understanding the political economy of subsidies reform. Most critical is creativity in involving diverse stakeholders and other decision makers in the reform efforts.
- f) *Entitlement mentalities develop quickly and can hamper subsidies reform.* This can have implications for use of transition measures and short term adjustment, including broader demonstration or equity effects for others facing structural reform. Thus there is an open debate on how to handle transitions in subsidy and associated structural reform. It was widely acknowledged that subsidies can hamper structural reform and adaptive management. However, transition management is a critical part of reform. Over-attention to comparative statics and insufficient attention to transitions may hamper reform results. In this context, the workshop discussed the importance of signals – political and otherwise – and the potential harm of not sticking to established timetables that had influenced economic and other decisions.

Unresolved debate

There were some aspects of the workshop for which debate did not lead to a convergence of views.

First is the issue of the role for, and evaluation of, environmentally-motivated subsidies (subsidies for environmental goods). Even the definition of this category of subsidies was difficult to reconcile (simple inducements to environmentally responsive behaviour? or accelerated adoption of environmentally beneficial technologies etc that would not otherwise have occurred?). The discussion tended to dismiss these kinds of subsidies as non-problematic – possibly overly generously, as issues were also raised in relation to policy efficiency, definition, expectations, impacts on adaptive management and the like.

Second was a debate on the need and role for common definitions and data on subsidies across countries, and the role this played in the reform agenda. Those participants most interested in multilateral levers for reform (*e.g.*, WTO rules) tended to insist on this as first priority, and lack of progress in this area as an impediment to reform. Others argued that reform needed in domestic contexts can proceed apace without such a step, although domestically relevant analysis is certainly needed (either way, some data collection and definitions are necessary to assist transparency). Although this workshop focussed more on the political economy of reform itself, and not on multilateral issues of data collection and comparability such as might have been the case earlier in the project, the discussion sometimes mired in this debate. It was difficult to discern whether this simply represented the nature of the experts in attendance, as opposed to a critical aspect of the momentum for subsidies reform. The likely message is that both reform and analysis need to continue on a parallel track.

Third was a related undercurrent to the discussions of whether subsidies reform requires multilateral rules to force reform, in relation to other drivers. A related discussion also took place on the likelihood of successful proactive reform. This manifest itself, in part, in discussions on the experts and topics most appropriate to future

workshops on subsidies reform in the environmental context (*i.e.* trade officials should attend to gather information on the environmental harm of subsidies as ammunition to strong rules (as drivers of reform), versus an desire to continue to share experiences on how to implement subsidies reform). It is the opinion of this Chair that the normative work may have run its course for the moment and – just like the policy development cycle itself – that which follows the data gathering and analytical stage is naturally a focus on how decisions should be successfully implemented.

Last, I would draw attention to the debate on the role of consultations. On the whole it tended to be agreed that consultation – including with potential “losers from reform” was essential – not only to attempt to build buy-in to change and understand impacts that need to be managed, but also to ensure that reform processes are broadly perceived as fair and legitimate/transparent. However, the view was not universal, and there were arguments that such inclusiveness merely enables rent-seeking behaviour and potentially slows reform relative to a more closed approach.

Conclusions

In conclusion, it was increasingly clear in this workshop that when talking about implementation of reforms, the environmentally harmful subsidies agenda is one that is cross-cutting and requires an interdisciplinary approach – similar to that of sustainable development itself. There is an underlying tension with this and traditional approaches on environmentally harmful subsidies that have been driven in large part by environmental and trade proponents. These aspects remain critical to the debate, but the project – if it is to focus on the implementation phase of subsidies reform – must now mature into a broader set of interdisciplinary discussions and issues, including building on the skills of those who can share best practices in decision-making and governance.

It is recommended that a fourth workshop continue to focus on the political economy of reform, but perhaps there may be room for focus on particular aspects of that challenge. In any case, case studies should be carefully managed in order to ensure that they are comparable in the manner in which they address the topics, in order to ensure that the greatest possible contribution can be made from them. The case studies presented in this workshop, along with the efforts of other participants and presenters, have already made a major contribution to our understanding of the challenges of removing environmentally harmful subsidies, and how to ensure we move into that coveted win-win-win box of economic, environmental and social sustainability and resilience. I was pleased to take part in these discussions.