Subsidies to Fossil Fuels 2020:
More, give me a little more

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FUNDACIÓN AMBIENTE Y RECURSOS NATURALES

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On September 16, 2019, the National Public Administration **bill** for 2020 was published; this bill will be introduced in Congress after the October 27 elections. However, its analysis allows setting, a priori, the state's course of action for next year on the subject of fossil fuels.

Both the progress report (published in June) and the budget message, which accompanies the bill, show the importance that the energy sector will have for the domestic economy, along with Vaca Muerta and its promise of exports.

A 1% Gross Domestic Product (GDP) increase is projected for next year, consistent with a 7% export growth, particularly linked to the energy sector as a consequence of Vaca Muerta's development.

The report specifically mentions oil and gas extraction as the *"driving force of economic activity"* since 2016, with a special reference to unconventional hydrocarbons, as a result of an agreement between the Executive Power, the unions, the provincial governments and the companies (Ministry of Finance, 2019).

Within the framework of the Secretariat of Energy (SGE, as per its Spanish acronym) 2020 budget, five (5) strategic guidelines were established for next year, which seek to expand the energy infrastructure and boost the sector's competitiveness in order to integrate it to the energy market. This would allow promoting fiscal sustainability and cooperating globally with climate change mitigation.

In order to comply with the guidelines, several objectives are defined. The first of them is *"striving for a balanced energy matrix, compatible with environmental care, through policies that foster the growth of domestic production of hydrocarbons, and at the same time allow the inclusion of renewable energies."* Regarding this topic, we point out the oxymoron implied by having a matrix that is compatible with the environment and that fosters (at the same time) the domestic production of hydrocarbons, not only onshore but also offshore.

The official reference to energy subsidies

The proposed budget message mentions a **0.47% of GDP** reduction **of economic subsidies in general:** 0.33% corresponding to energy subsidies and 0.14% to transport subsidies.

Energy subsidies are the State's main expenditure, closely dependent on the value of the exchange rate. In this regard, the variation of the exchange rate and its impact on the budget is analyzed: if the exchange rate increased 1% in the projection, it would lead to an additional need for subsidies of around **0.02% of GDP ($6.6 additional million to the current projection).**

However, in determining the energy incentives, international prices are also important *"based on the National Administration's expenditure on subsidies."* For example, a 1% decrease in energy international prices would result in lower expenditures on subsidies: 0.01% of GDP ($1.6 million). However, this fall would have negative impacts on the national accounts, as it would also result in a lower collection, representing 0.01% of GDP ($3.2 million)[1] and in a worsening of the National Administration's primary result, representing 0.005% of GDP ($1.5 million).

1. It is necessary to clarify that on pages 135 and 136 of the proposed budget message two different values are mentioned for the figure 0.01% of GDP: 3.2 and 1.6 million. The data shown in this paragraph are taken verbatim from the public document.

Notably, **energy subsidies identified by the government for 2020 are estimated at $280,643 million, 5.2% over the figure for 2019[2]. This amount doubles the budget for social programs such as the Universal Allowance for Social Protection** ($167.8 million), **and exceeds by 25%** ($209,036 million) **the transfers that will be made to national universities.**

Several SGE objectives make (underlying) reference to subsidies; a mention is made about the need to *"normalize the rates of licensed companies that transport and distribute natural gas and to promote and foster investments on developments for the production of natural gas from non-conventional reservoirs,"* which includes not only answering to the domestic demand but also fostering *"natural gas exports both to neighboring countries and new markets"* and also highlights the need to have transport and storage infrastructure for that purpose.

The other budget subsidies

If we take the definition of budget from the World Trade Organization (WTO)[3], which includes any financial contribution that the government makes to an activity and/or any form of income or prices support, we can conclude that the methodology used by the government leaves other budget allocations out, also devoted to fostering fossils.

Subsidies for **fossil fuels** identified by FARN (based on the before mentioned definition) **total in 2020 $307,136 million, 9.4% over those identified by the government**, which represents a 36% hike in nominal terms with regard to those budgeted for 2019. However, if the year-on-year August inflation rate (INDEC, 2019) is contemplated, subsidies decreased 12% in real terms.

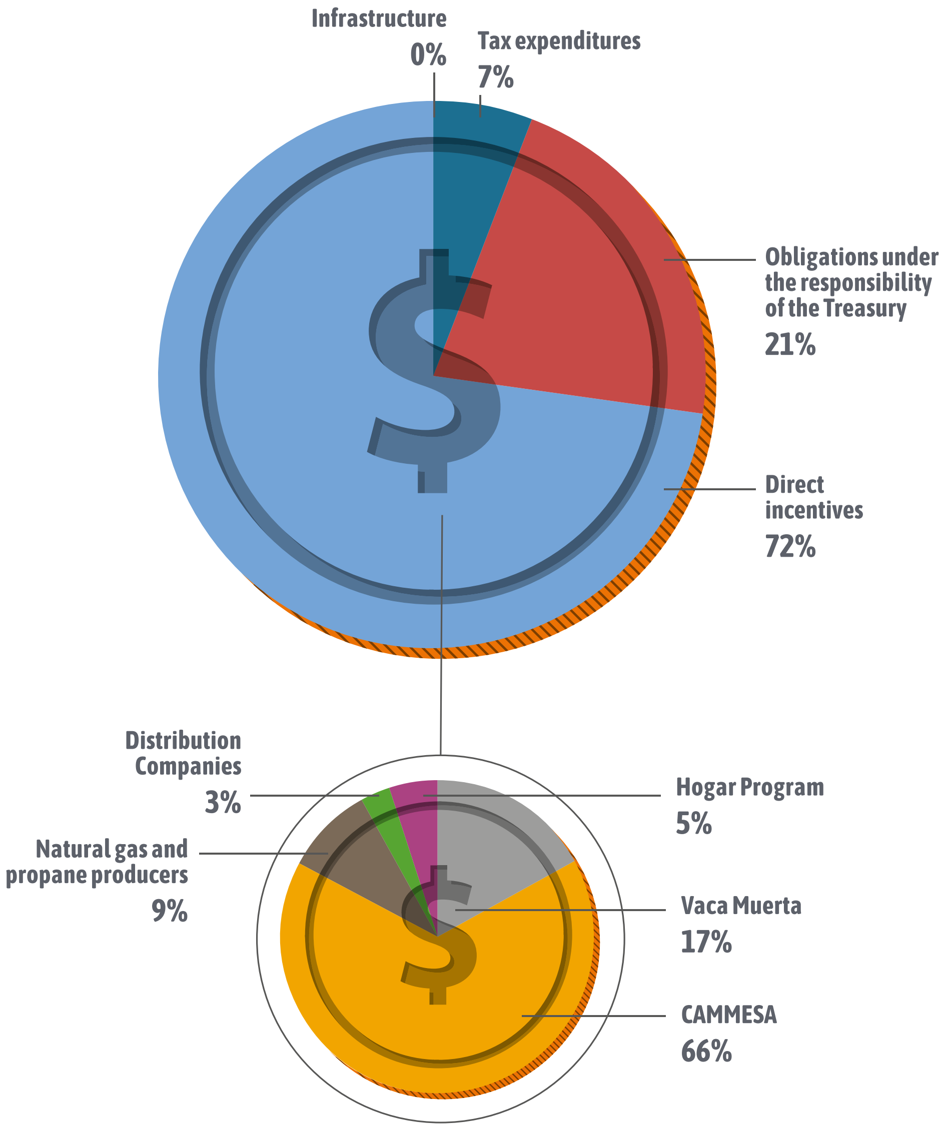
Subsidies represent 5% of the 2020 national budget ($6,247,756 in total), 91% of the SGE budget and 86% of the Ministry of Finance budget. Likewise, they amount to 27 million minimum wages, 33 million retirement pensions and 162 million universal child care allowances.

The biggest difference in the year-on-year comparison is given by budget allocations and tax expenditure tied to infrastructure works, with an 84% fall in nominal terms. The biggest increase is associated to the allocation to demand-side subsidies; however, analyzing its components, the biggest difference is found in the compensations that propane gas producers will receive, which will go from $1,083 million to $20,606 million.

Of the total value of expenditures proposed for fossils in 2020, 72% correspond to direct incentives, 21% to financial aid from the State to different areas of the public and private energy sectors, and 7% to tax expenditure (chart 1).

2. In 2019, the proposed budget message set forth that $201,929 million would be spent throughout that year, an amount that was updated to $266,800 million on the 2020 budget message, an increase of around 32%.
3. Established in the Agreement on Subsidies and Countervailing Measures. Among the measures, the following can be found:
- direct transfer of funds (for example, donations, loans and capital contribution) or liabilities (for example, loan guarantees);
- cancellation of debt by the tax authorities (for example, incentives such as tax relief);
- proportion of goods and services (not general infrastructure) or purchase of goods;
- finance mechanisms.

Chart 1: Subsidies to fossil fuels on the 2020 budget bill



Source: compilation based on data from the Ministry of Finance (2019)

If direct incentives for fossil fuels on the 2020 budget are particularly analyzed, 95% are received by companies related to the exploitation and/or distribution of hydrocarbons, while 5% are allocated directly to consumers. Direct incentives to private companies for gas extraction in Vaca Muerta represent 13% of the total subsidies.

Subsidies in detail

Programs and budget allocations with SGE financing related to fossil fuels are several.

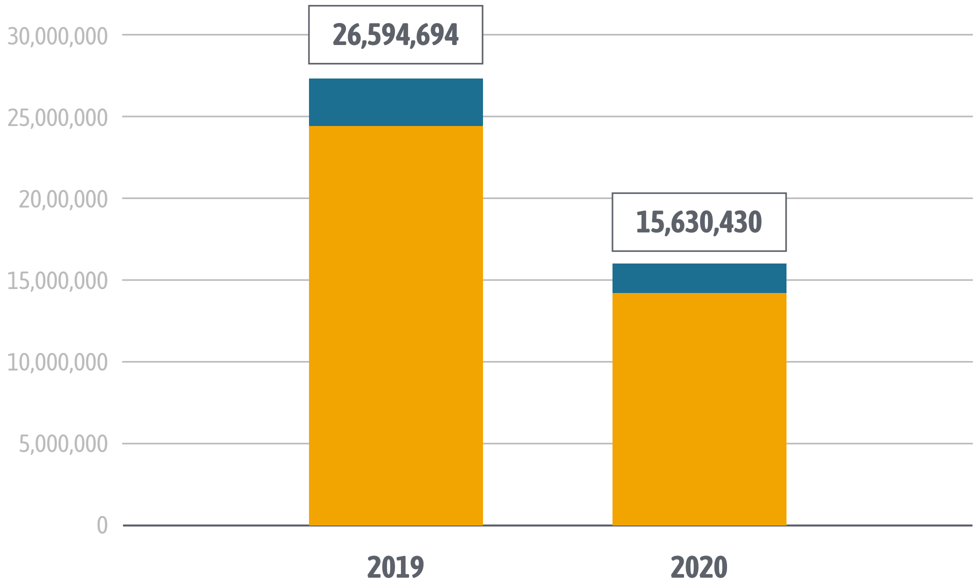
The first one is the **Formulation and Implementation of Policy on Hydrocarbons**, whose goal is *"restoring the principles of free availability of hydrocarbons and the free play of supply and demand in price determination."* The key objectives for this program are (together with incentives in various forms): to increase hydrocarbons' supply – through incentives for exploration and exploitation of crude oil and gas fields and the production of derivatives – , to continue fostering investments on nonconventional natural gas fields – through specific incentives programs to *"harness Vaca Muerta's potential"* – , to apply incentives for offshore exploration and exploitation of hydrocarbons, as well as to promote private investment in oil and the increase of diesel oil and gas production.

Supply-side subsidies total $38,707 million in order to facilitate the exploration and exploitation of nonconventional fields, whose purpose is the Incentive for the Production of Nonconventional Hydrocarbons in the Neuquén basin: $34,062 will be received by private companies (88%) and the remaining 12% by the provincial governments who collects royalties for the exploitation of Vaca Muerta ($4,644 million). This amount implies a 21% rise of subsidies in nominal terms compared to 2019, associated to setting economic incentives in foreign currency.

A 0.76% year-on-year increase of the gas production is expected by subsidizing the extraction of 7,213 million m3 of nonconventional natural gas. That would imply paying $5.37/m^3 for the extracted gas as a result of the subsidy. The amount increased in comparison with the extraction budgeted for 2019 (12,274 million m3), at $2.60/m3. The difference is not only due to a lower amount budgeted for subsidies in 2019, but also to a higher gas extraction foreseen for that year.

Therefore, through the subsidies that the government devotes to Vaca Muerta in order to increase gas extraction in partnership, greenhouse gas emissions also increase. **It is estimated that the subsidies for 2019 and 2020 increased emissions in 42,225,124 tCO2e in the last two years (author's calculations, with the support of UNICEN, National University of Central Buenos Aires; see chart 2). This amount represents, respectively, 7 and 4% of the total greenhouse gas emissions in the country,** according to data available in the inventory for 2014 (MAyDS, 2017), which is far from being a solution for climate impact in our country.

Chart 2: Emissions of subsidized gas (data in tCO2e)



Source: author's calculations, with the support of UNICEN, based on emission factors from the 2016 IPCC Methodologies Volume 2, and data published on the SGE budget for 2019 and 2020

In turn, **demand-side subsidies** seek to compensate the lower revenue that the licensed companies that distribute natural gas through the network receive from users, in contrast with those established in the current rates, which total $37,347 million. However, when breaking down these data, it becomes clear that propane gas producers receive 55% of these funds.

By means of these subsidies, through the HOGAR Program[4] for low income households, the goal is to benefit 2,300,000 households with $10,316.3 million which seek to ensure access to bottled Liquefied petroleum gas (LPG) among low income users. This fund covers $183 per cylinder (SGE, 2019), which represents between 40 and 60% of its total value (depending on its size). This program is supposed to help each of these households purchase 2 cylinders per month.

Additionally, by means of the Financial Support to Gas Distributing Companies[5], these companies will receive $6,424 million in order to reduce the impact of the rate hike on 419,962 service bills from gas network users. While the Compensation to Network Undiluted Propane and Natural Gas Producers[6], in the framework of the Fiduciary Fund for Subsidies on Residential Gas Consumption[7] for $20,606 million, implies that **propane producers receive 55% of the subsidies categorized as demand-side subsidies.**

4. Set forth by Law No 26,020, benefiting, by means of direct transfer, low income households which have no access to the natural gas network.
5. Resolution No 508/2017 from the former Ministry of Energy.
6. Resolution No 148/2019 from SGE.
7. Article 75-Law No 25,565. In the framework of article 54 from the budget bill, the following is set forth: "The Fiduciary Fund for Subsidies on Residential Gas Consumption aims at financing a) the compensations for a differential in the prices for natural gas and Liquefied petroleum gas (LPG) for the Patagonia Region, the Department of Malargüe in the Province of Mendoza, and the Region known as 'Puna', which suppliers should receive on the gas they deliver to the distributors or sub-distributors in those areas for residential consumption, for the application of differential rates to said consumption, and b) the sale of cylinders or LPG, propane gas in bulk and others, in the provinces located in the Patagonia Region, the Department of Malargüe in the Province of Mendoza, and the Region known as 'Puna'. The mentioned Fund shall be established with an extra charge of up to 7.5 % over the price of natural gas at the point of entry in the transport system, for every m3 out of 9.3 kc, which will be applied to the total cubic meters consumed and/or commercialized through the network or ducts in the National Territory regardless of the nature of its use or final use.

In the program **Formulation and Implementation of Policy on Hydrocarbons**, the focus is on the importance of adjusting the *"existing gas transport infrastructure to guarantee the necessary capacity to carry the production towards centers of consumption and/or export."* For that purpose, 3 works associated to gas transport, which total $357 million, are budgeted.

Regarding the infrastructure for Vaca Muerta, the North Patagonia Train appears among the works to be executed through Private-Public Participation (PPP), estimating expenditures by the National Administration only for 2024 of $199 million.

Finally, the program **Formulation and Implementation of Policy on Electrical energy** frames actions associated with the drafting of public policies on electrical energy and monitoring the market's behavior. The objective is to enhance the participation of hydroelectric generation in the supply of electrical energy. Through the Sustainability of the Electricity Market budget allocation for $145,986 million, the Wholesale Electricity Market Management Company (CAMMESA, as per its Spanish acronym) receives State funds *"to compensate the electricity market stabilization fund, as it is deficient in connection to the generation, transport and distribution operations, which are carried out within the Argentine Interconnection System"* (ME, 2018).

The State program is expected to cover 63% of the Wholesale Electricity Costs of the rate paid by users, and to subsidize 131,127,000 MWh of the electrical energy supply.

In turn, the **Obligations under the responsibility of the Treasury**[8] set forth expenditures to finance fuel imports made by the company Integración Energética Argentina S.A. (IEASA) to sell in the domestic market at a differential price, as well as expenditures associated to Yacyretá and projects from the companies DIOXITEK S.A. and Integración Energética Argentina S.A. (IEASA), which total $65,280 million. However, given the level of aggregation of the data, it is not possible to identify the share of these funds that are especially devoted to fossil fuels. Unlike what is established in the 2019 budget, the obligations render account of the operating costs for Yacimiento Carboníferos Río Turbio.

Regarding **Tax expenditures**, it is estimated that next year **$19,456 million** will no longer be received due to tax exemptions related to the Regime for the production and sustainable use of biofuels (Laws No. 26,093 and 26,334). For 2020, tax expenditures were not budgeted in the framework of tax benefits for the import of equipment used in works of energy generation related to gas and oil exploration, production and exploitation, among others,[9] a program that was estimated at $6.213 million for 2019.

Furthermore, on Article 59 of the Bill, the works carried out by trusts Manuel Belgrano Thermoelectric power station, Timbúes Thermoelectric power station, Vuelta de Obligado Power station and Guillermo Brown Thermoelectric power station are exempted from all national taxes, whose value has not been mentioned.

8. The Obligations under the responsibility of the Treasury show the financial aid to different areas in the public and private sectors from the State and also obligations emerging from commitments with provincial, national and international bodies.

9. The framework of these exemptions is the Critical Infrastructure Works, Law 26,422, article 34, which sets forth: "They are exempted from paying the right to import and the rates of statistics and verification to import, for the consumption of new goods and those not produced in the country, devoted to infrastructure works whose object constitutes:
a) the generation, transport and distribution of electrical energy;
b) the exploration, production and exploitation of gas and oil;
c) the construction of new oil refineries and extension of existing ones;
d) the transport, storage and/or distribution of hydrocarbons."

Final words

The efforts from the government to reduce the amount of subsidies seem to be more a response to the economic crisis than a climatic concern. In particular, the articles and the proposed budget message constantly manifest the need to foster the extraction of hydrocarbons (from Vaca Muerta and its promise of exports, as well as offshore), using the term “incentives” as a key word.

In nominal terms, subsidies will increase 9.4% in 2020 compared to this year. However, the value of the subsidies is understated in the budgets, which is repeated year after year, given the weak estimations regarding the value of the exchange rate. That is why it is important not only to analyze the budget, which shows a trend, but also to review the budget implementation that indicates the real statement of financial position regarding the subsidies.

Subsidies represent 5% of the 2020 national budget, 91% of the SGE budget and 86% of the Ministry of Finance budget.

Far from any environmental commitment, these incentives respond to a key objective for the government: increasing energy exports and generating foreign currency due to the introduction in the balance of trade of a new export product, gas.

Finally, in the words of the Report of the Special Rapporteur on the issue of human rights obligations, *“in order to address society’s addiction to fossil fuels, States should put an immediate end to all subsidies for fossil fuels”* (UN, 2019).

Sources

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