

# 4 Special Feature: Policy responses to rising energy prices

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This chapter is a Special Feature, which provides an overview of the measures adopted by OECD countries and Inclusive Framework jurisdictions in response to rising energy prices, as well as some policy recommendations in the event that prices remain elevated. The Special Feature is based on a joint Policy Brief produced by the Centre for Tax Policy and Administration, the Economics Department, the Environment Directorate and the Trade and Agriculture Directorate.

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## 4.1. Introduction

**Energy prices have been soaring since early 2021 due to a combination of supply and demand factors.** These include long-term trends such as underinvestment in natural gas and clean energy supply, and short-term developments like reductions in natural gas spot delivery by Russia and a strong recovery in demand in the aftermath of the COVID-19 slump (IEA, 2021<sup>[1]</sup>). Russia's invasion of Ukraine has put further strain on already tight energy markets and increased uncertainty over the near-term development of supply. Russia has cut off energy supply to several countries, and others have introduced embargoes on Russian energy imports.

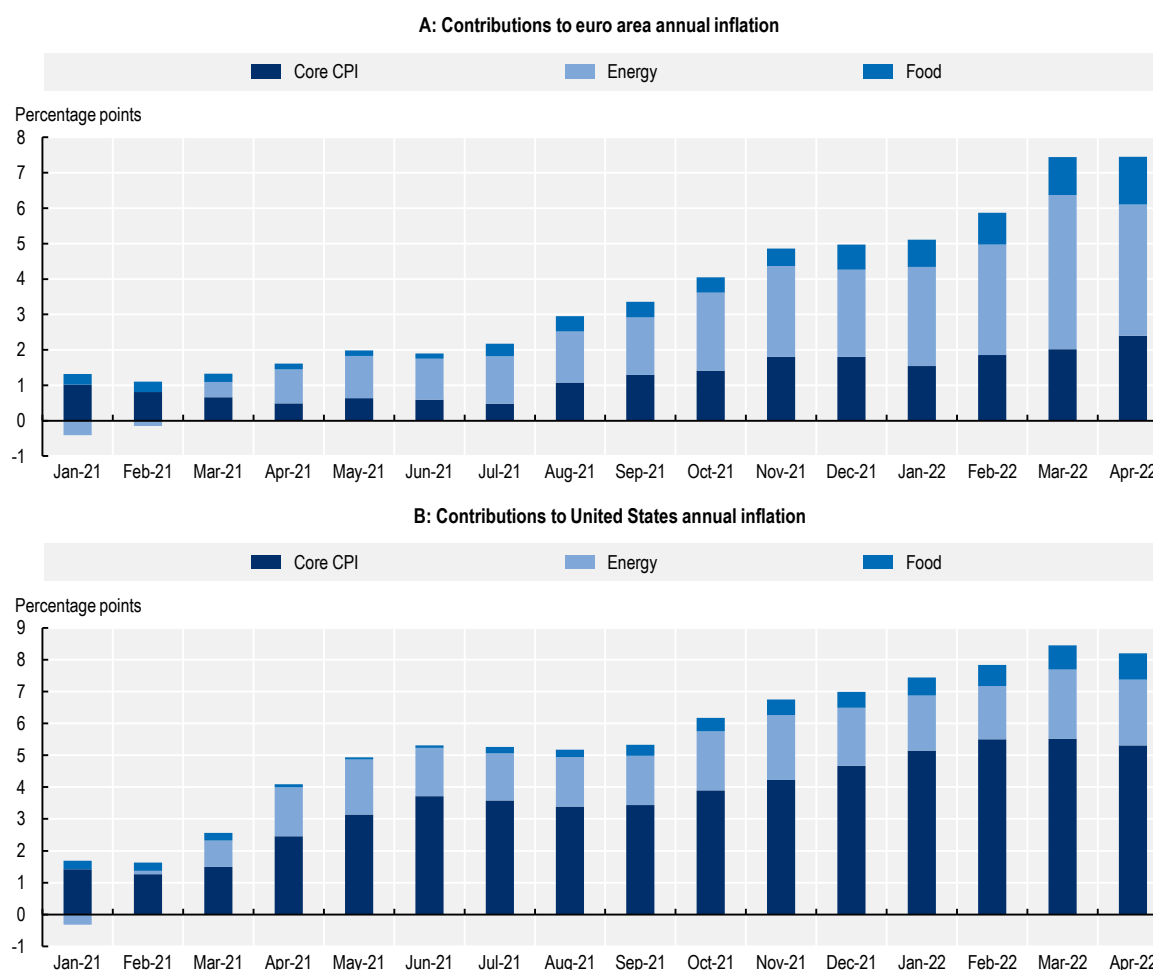
**The International Energy Agency (IEA) predicts that high prices of petroleum and gas products are here to stay.** This is despite the fact that steadily rising oil supply volumes from the Middle East and the United States, along with slower economic growth, are expected to mitigate oil and gas supply constraints due to the Russian supply disruption.<sup>1</sup> Volatility of energy prices has also been extremely high. As a result, the energy crisis is now contributing to rising inflation pressures across the world (OECD, 2022<sup>[2]</sup>) (Figure 4.1).

**Energy users have few options to cut demand drastically in the very short run, meaning that concerns over energy affordability and the cost of living loom large.**<sup>2</sup> Price shocks have had significant adverse effects on households and businesses, which has prompted governments to respond (Boone and Elgouacem, 2021<sup>[3]</sup>). This Special Feature takes stock of the responses and considers their respective merits and drawbacks.<sup>3</sup> It also highlights the challenges of providing well-designed income support, including for the transition to carbon neutrality.


**Support measures can be classified in several ways, but a key distinction is between income support – i.e., transfers to households and businesses – and price support measures, which seek to reduce energy prices paid by consumers.** Income support can be delivered through transfers or vouchers to households and firms. In times of crisis, income support measures already in place can be extended to a wider population or the amount of existing transfers can be increased.

**Price support measures can take the form of, for instance, price controls, reduced electricity excise taxes and network fees, value added tax (VAT) and fuel excise tax reductions or exemptions, and rebates at the pump.** Both income support and price control measures can be targeted, either through means-testing or by restricting the benefit of the measures to certain specific categories of energy consumers based on some criteria, such as energy consumption, income, or residence.

**Figure 4.1. Relative contribution of factors to headline inflation rates in the euro area and the United States**



Source: OECD (2022<sup>[4]</sup>); OECD Eurostat Harmonised Indices of Consumer Prices, OECD Consumer Price Indices.

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**The key message of this Special Feature is that governments will need to shift from policies that directly seek to limit price increases to those that cushion their impact through targeted income support.** This approach will ensure that the support provided is fair and effective, while limiting its effects on government budgets and maintaining price signals to encourage the transition to carbon neutrality. However, even the most sophisticated fiscal systems may not be fully geared to the task, calling for action to improve their capacity to target specific groups. In addition, broad access to alternative energy sources is a prerequisite for an effective and publicly acceptable longer-term strategy to shift away from fossil fuels.

## 4.2. Government support measures

**This Chapter draws on data collected by the OECD on government support measures implemented in 89 jurisdictions, including 74 member jurisdictions of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting<sup>4</sup> since the onset of the energy crisis in the third quarter of 2021.**

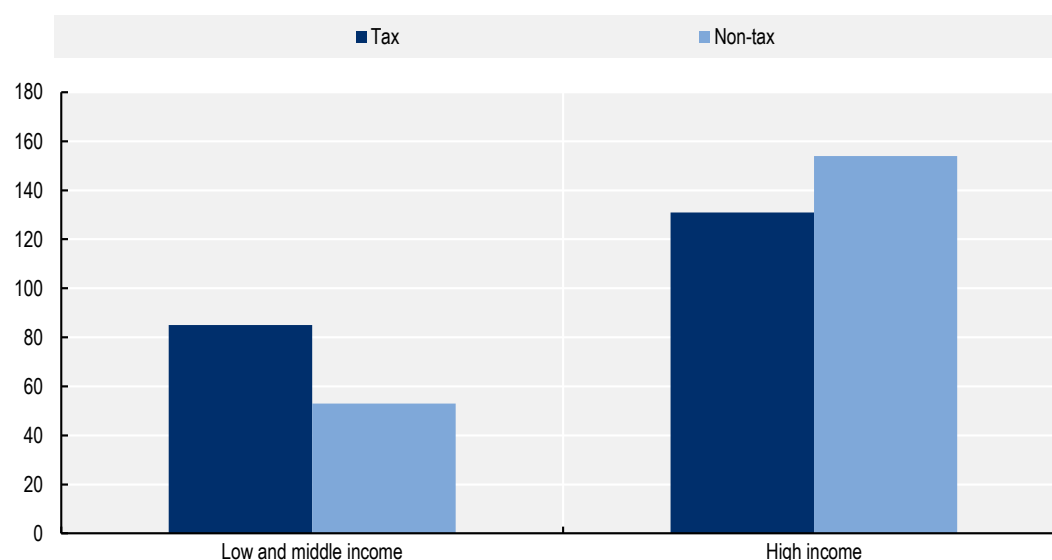
As of 30 May 2022, the information collected covered over 350 measures designed to cushion the impact of rising energy prices in the short run. Some governments have also estimated the fiscal costs of the key measures, in terms of either resources spent or revenue foregone.

#### 4.2.1. A common government response has been to temporarily reduce fuel and electricity excises

**Governments have responded to rising energy prices with a wide variety of tax and non-tax measures.** The majority of measures introduced in high-income countries have tended to be non-tax measures such as subsidies, transfers, or other regulatory interventions, while tax measures have been more prevalent in low- and middle-income countries (Figure 4.2). In a large proportion of cases, the differences in approaches adopted are most likely due to the existence of more developed transfer and benefit systems in higher-income countries, which are generally better equipped to target support to “at-risk” populations.


**Figure 4.2. Government measures introduced in response to rising energy prices, September 2021 to May 2022**

Count of the number of measures introduced by governments



Note: Measures up to date as of 25 May 2022. Country income status reflects World Bank classifications.

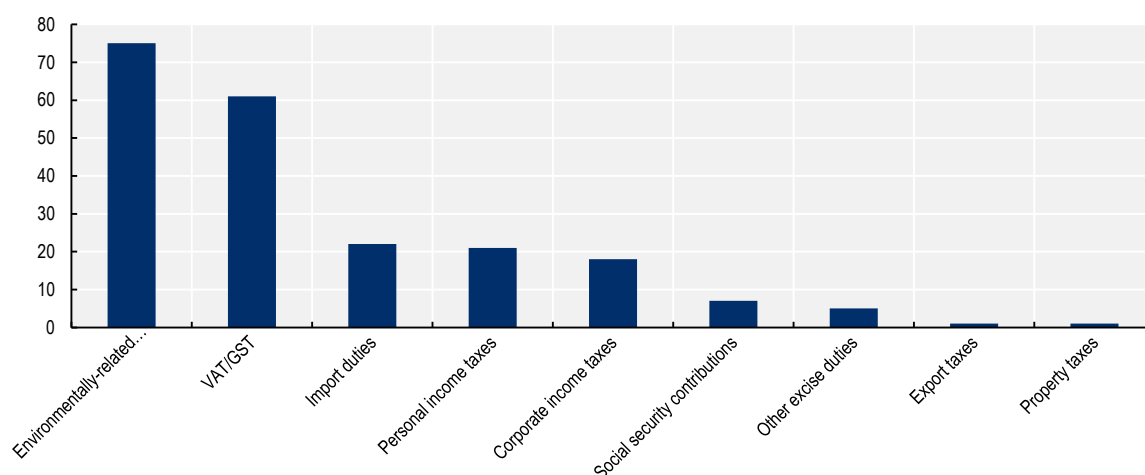
Source: OECD Working Party 2 Delegate responses.

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**Temporary indirect tax reductions have been the most common form of tax measure implemented by countries.** Reductions in environmentally related taxes, largely cuts in excise taxes on petroleum products, were the most frequently introduced measure to cushion the impact of rising prices, followed by decreases in the VAT/GST rate on fuel products, and lower import duties (Figure 4.3). Subsidies and cash transfers have been the most common non-tax measures implemented, with lower-income households being the primary target of both types of measures and businesses receiving some subsidy support in a small number of countries.


**Figure 4.3. Tax measures introduced in response to rising energy prices, September 2021 to May 2022**

Count of the number of tax measures introduced by governments



Note: Measures up to date as of 25 May 2022.

Source: OECD Working Party 2 Delegate responses.

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**Excise taxes were cut in 73 of the 89 jurisdictions covered by the database, mainly for petroleum products.** The largest cuts in excise duties per litre of gasoline were implemented in Germany (EUR 0.30 for three months starting from June 2022), Italy (EUR 0.25 from March 2022 until at least 8 July 2022), Ireland (EUR 0.20 for petrol and EUR 0.15 for diesel for six months starting from March 2022), Korea (KRW 264 (EUR 0.23) for three months from May 2022) and Belgium (EUR 0.175 from 19 March 2022 until at least the end of December 2022).<sup>5</sup> A number of countries initially implemented excise tax cuts for short periods of around a month when they were first introduced, but with energy prices remaining high, these measures were often extended (in some cases, on several occasions) and many countries also increased the size of the excise tax cut. Some countries temporarily removed excise duties on tax altogether while others provided tax credits on fuel duties or decided against planned increases. Other environmentally related tax measures included lowering excise taxes on electricity, delaying new taxes (and rises to existing taxes) on coal, and providing excise duty holidays for the purchase of electric vehicles.

**VAT reductions on energy products have also been a common policy response, mostly in European countries and most frequently for electricity and natural gas products.** As Europe was one of the first regions to experience rising energy prices, EU countries were among the first countries to introduce VAT cuts. Similar to the excise duty cuts, most cuts to VAT were announced as temporary measures, but in several cases have been increased or extended, in some cases on several occasions. In June 2021, Spain reduced the VAT rate on energy bills from 21% to 10%; the measure has been extended several times since. Then in October 2021, Italy cut its VAT rate on the use of natural gas supplies for “civil and industrial uses” to 5%, before Cyprus announced reductions in the VAT rate on electricity and gas (from 19% to 5% for vulnerable groups, and to 9% for all other households) and the Czech Republic announced a VAT exemption in November 2021. Several other European countries followed suit in early 2022, including Belgium, Estonia, Lithuania, North Macedonia, and Poland. Türkiye also reduced the VAT rate on electricity used in residents and agricultural irrigation from 18% to 8% from March 2022. Outside of Europe, in March 2022 Barbados capped the VAT payable on gas and diesel (in US dollars) for six months and the

Costa Rican government introduced a VAT exemption for purchases of electrical energy intended for distribution. From April 2022, El Salvador temporarily reduced the VAT rate on fuels and Kenya halved the VAT rate on automotive fuels to 8% as part of its 2022 budget. Other VAT measures have included temporary VAT holidays for the purchase of electric bicycles and cars (Barbados; British Columbia, Canada<sup>6</sup>) and greater flexibility with respect to VAT repayments for businesses. Some countries have targeted VAT measures towards businesses and to the agricultural sector, including Greece.

**Reforms to import duties, personal income taxes (PIT) and corporate income taxes (CIT) have also been introduced in some jurisdictions.** Almost all natural resource importing countries have reduced import duties on energy supplies to help soften price rises. Several countries have increased the value of commuting expenses that can be deducted from the PIT, including in Austria, Finland, France, Germany, and Sweden, while Mexico has introduced a complementary tax credit on fuel excise duties, which fuel importers and producers can use to offset monthly CIT or VAT payments. CIT credits were also introduced in Italy to support businesses struggling with rising energy costs, ranging from 12-25% depending on the energy-intensity of companies' activities. In Austria, the government introduced a 50% reduction in advance PIT payments to ease the PIT burden for entrepreneurs.

**Subsidies and transfers have been central to policy packages, particularly in higher income countries.** Targeted support to vulnerable groups has been more commonplace relative to the tax measures described above, with subsidies often directly deducted from energy bills and cash transfers often targeted to poorer and more vulnerable groups. Cash transfers were provided in over a third of the 81 countries covered and of all the cash transfer measures introduced, three quarters were targeted at specific households. In a handful of countries, governments have sought to reduce petroleum prices directly through subsidies, whether through ad hoc refunds to customers (e.g., France) or through pre-existing petroleum price stabilisation funds (such as in Chile, Kenya, and Thailand). For electricity and heating fuels, subsidies benefitting all households were distributed in several countries. Examples include a EUR 100 (USD 118) heating voucher deducted directly from the electricity bill for all households in Belgium (and EUR 225 (USD 281) for households using heating oil), a 10% discount on electricity bills in Cyprus, and a subsidy covering 80% of the cost of energy bills above NOK 0.70 (USD 0.08) per kilowatt-hour in Norway. Some countries also reduced charges and regulatory fees on electricity tariffs.

**Several countries provided additional incentives to save energy.** Public transport subsidies were provided in Austria, Germany, Ireland, New Zealand, and Singapore. In some countries, these subsidies were available to all households, while in others, they were restricted to poorer families only. Belgium, Portugal, and the United Kingdom were among the countries to provide VAT exemptions or reduced VAT rates for the purchase of energy-saving and renewable energy products, such as solar panels, solar water heaters and heat pumps. Energy efficiency subsidies were introduced in Luxembourg, the Netherlands and Romania, among others.

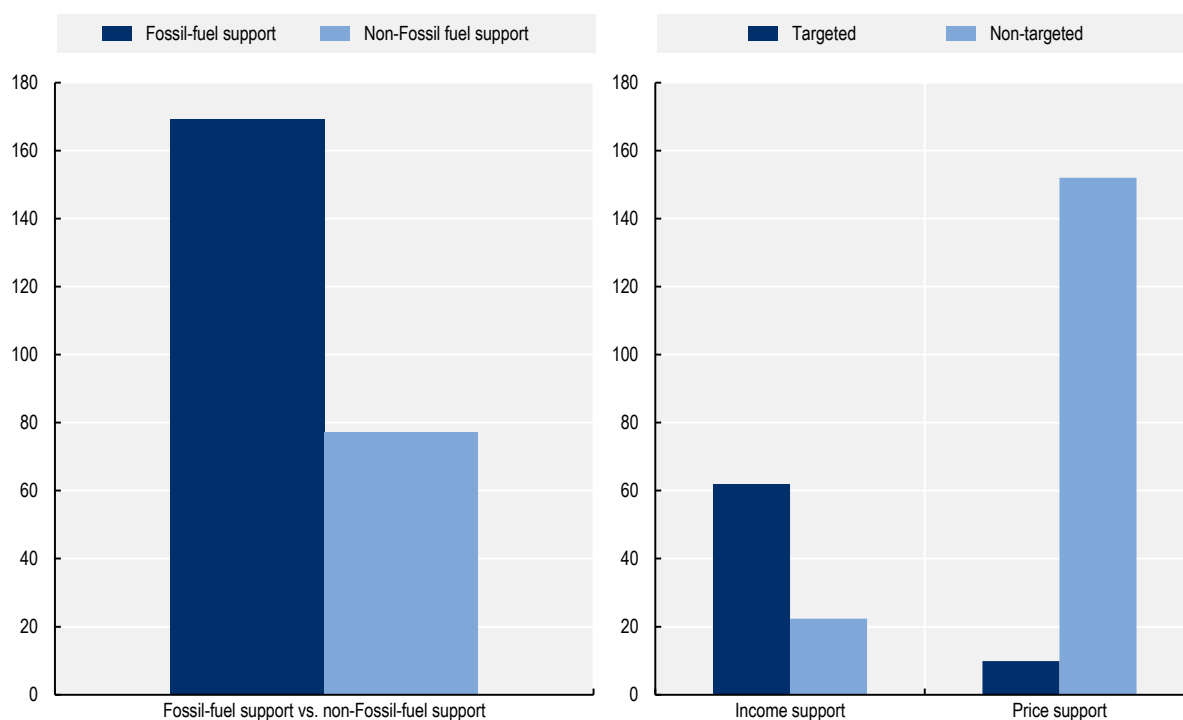
**A small number of European countries have also announced plans to implement windfall profits taxes to support the cost of the measures they have introduced.** Bulgaria and Romania announced windfall profits taxes on its nuclear power plant, and for energy producers on revenues exceeding EUR 91/MWh, respectively, from October 2021. In March 2022, Italy imposed a 10% windfall profits tax (*contributo solidaristico straordinario*) on energy companies and intermediaries that experienced a year-on-year increase in earnings of at least EUR 5 million between October 2021 and March 2022. Italy then raised the tax rate to 25% at the beginning of May 2022. Following suit, in May, Greece imposed a 90% windfall tax on the additional profits made by electricity power generators from October 2021 to June 2022 and the United Kingdom announced an *Energy Profits Levy*, whereby a 25% tax rate will be applied to the "extraordinary" profits made by oil and gas companies up until 2025. The measure will include an investment allowance that oil and gas companies can use to reduce the tax base on which the levy applies if they reinvest these profits in the United Kingdom.

#### 4.2.2. The cost of measures introduced by governments has been significant

Data show that the cost of the support delivered so far is significant. The aggregate fiscal cost of measures provided since October 2021 and ending by December 2022<sup>7</sup> – i.e. summing the fiscal cost of measures for which an estimate is available – amounts to a total of USD 246 billion of which USD 169 billion has come in the form of support for fossil fuels (left-hand side of Figure 4.4).<sup>8</sup> This means that in a period of over 15 months, governments will have rolled out additional support in the order of magnitude of the regular annual support measures for fossil fuels being provided prior to the energy price hikes (USD 201 billion in 2019 and USD 182 billion in 2020).<sup>9</sup>

Figure 4.4. Cost of government responses to the energy crisis, October 2021 to December 2022

USD Billions



Note: (1) Measures classified as income support are those that provide lump-sum transfers to households or businesses to help alleviate energy cost increases. Price support includes all measures that reduce the post-tax energy price for all energy sources. These include price controls, reduced electricity charges and network fees, VAT and excise tax reductions, and compensation to distributors for selling energy products at reduced prices. Targeted measures are ones provided to specific groups, such as vulnerable households or businesses. Non-targeted measures apply to all consumers with no eligibility conditions. (2) Information on 284 measures was collected for 42 OECD and key partner economies, with 137 measures providing an estimated fiscal cost for a total of USD 246 billion between October 2021 and December 2022. (3) Fossil-fuel support measures imply a change in relative prices of energy sources that encourage the use of fossil fuels.

Source: OECD (2022<sup>[4]</sup>).

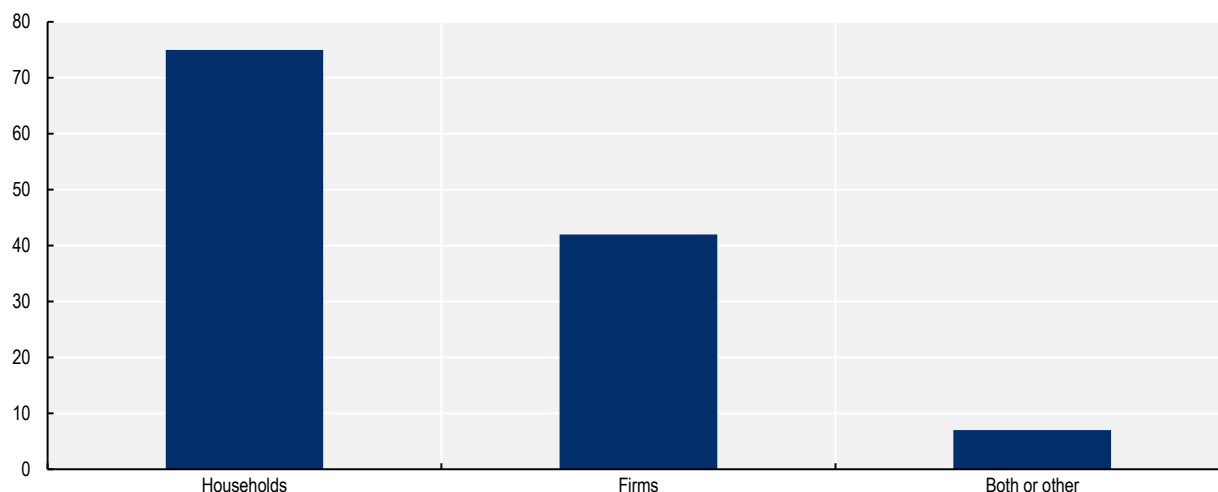
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**Governments' responses have focused largely on price control – which tends to support rather than curb demand.** Income support measures account for 34% of the total value of support provided through policies covered by the database (right-hand side of Figure 4.4). Most of these, 73%, have been targeted. By contrast, price support – 66% of the amount of total support provided – is in large part non-

targeted (94%).<sup>10</sup> In terms of counts of individual measures, most support has been directed towards households, and to a lesser extent, firms (Figure 4.5).

**Figure 4.5. Targeting of government support measures, March 2021 to May 2022**

Count of the number of measures



Source: OECD (2022<sup>[4]</sup>).

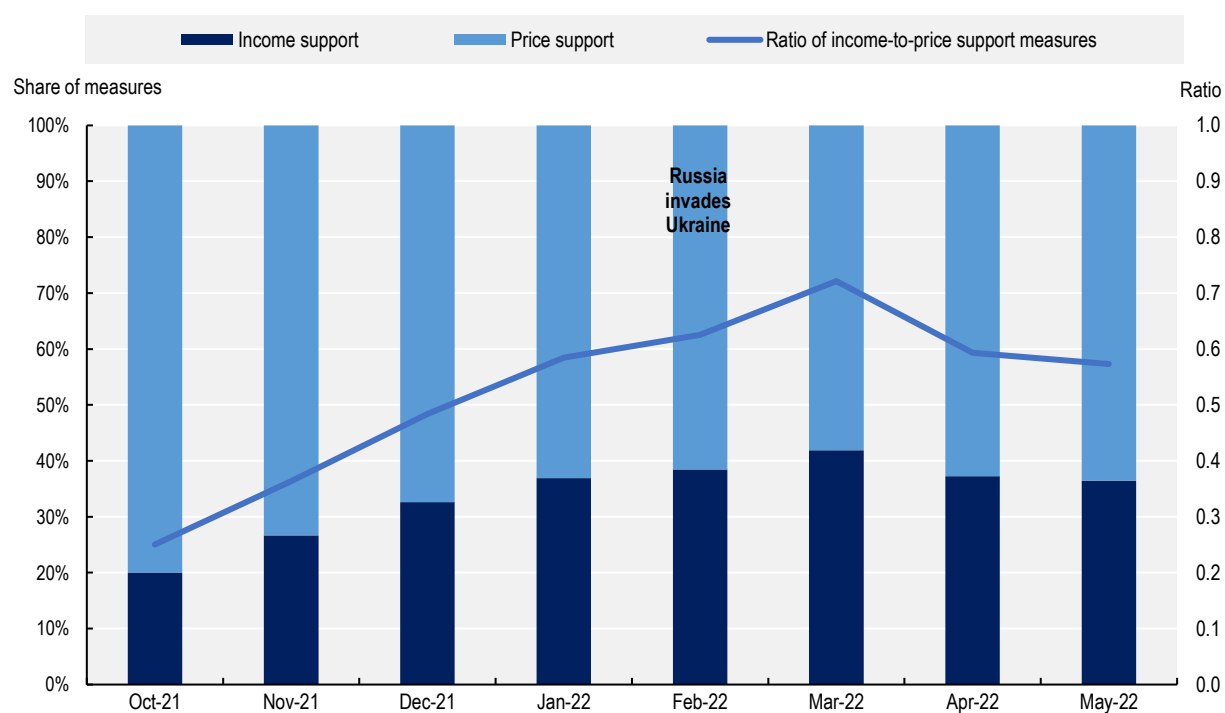
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**Initially, governments rolled out mainly price support measures, then gradually shifted to income support measures.** The war in Ukraine provoked further increases in energy prices, which caused governments to again turn to price-based policies, reversing the trend of a rising share of income-based policies (Figure 4.6). Such a pattern might reflect the relative ease with which price support measures can be administered when urgent action is needed – e.g., tax cuts can be implemented rapidly.

**More than two thirds of countries have combined price and income support policies.** These patterns generally hold in both OECD and non-OECD countries covered by the database, although non-OECD countries tend to rely more on price support measures. This may reflect a lack of capacity to administer sophisticated targeted income support programmes, particularly in emerging economies where informality is high and alternative energy sources are less developed (see Section 4.3).<sup>11</sup>



Figure 4.6. Relative share of income and price support measures, October 2021 to May 2022



Source: OECD (2022<sup>[4]</sup>).

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### 4.3. Policy observations

**Approaches to delivering support differ in their administrative ease, effectiveness, and alignment with other policy objectives.** To the extent that energy prices continue to remain high, support should strike a balance between effectiveness, budgetary and implementation costs, focusing on the strongest needs, and ensuring synergies with longer-term climate change and energy security objectives.

**To this end, there are several reasons why countries should move away from price support measures, which for the most part contribute to raising fossil fuel subsidies:**

- Price controls fix or cap the price of energy below market prices. While they are relatively simple to implement, they tend to be untargeted and benefits can accrue disproportionately to large energy consumers, who often have higher incomes.
- Price controls may also dampen price signals, limiting the incentive for energy savings or switching away from fossil fuels.
- When end-user energy (e.g., electricity, natural gas, and gasoline) prices are capped at below cost recovery, they can cause large losses further upstream in the energy supply chain thereby discouraging new infrastructure investments and ultimately exacerbating supply shortages (Guenette, 2020<sup>[5]</sup>). Even if governments compensate energy suppliers for their losses to ensure the continuation of their operations, implicit government guarantees typically weaken incentives for operational improvements. They can hence jeopardise the medium-term goals of ensuring energy

security and the transition to carbon neutrality. Despite their limitations, one advantage of price controls is that they also benefit individuals that fall outside of formal government welfare systems

- Price support measures can temporarily relieve inflationary pressures as they help lower inflationary expectations (Agénor and Knight, 1992<sup>[6]</sup>; Aparicio and Cavallo, 2021<sup>[7]</sup>). However, they do not allow for demand to adjust to supply constraints, which could exacerbate commodity shortages and sustain future inflation (Vaitilingam, 2022<sup>[8]</sup>; Neely, 2022<sup>[9]</sup>).

**Energy tax reductions, whether targeted at excise duties or value-added taxes, also seek to reduce the effective price that consumers pay.** Like price controls, these policies are relatively quick and simple to implement and communicate and reach individuals in the informal sector. But they also weaken price signals and hence the incentives to reduce consumption levels. Unlike price controls, energy tax cuts do not affect energy suppliers who still sell their products at market prices and avoid revenue losses. However, fiscal revenues immediately decrease, and the budgetary cost can be high over time.

**In addition, caution is warranted regarding the extent to which energy tax reductions translate into lower consumer prices.** For instance, a VAT rate cut does not guarantee a consumer price cut of the same extent (Benzarti, Carlonie and Kosonen, 2020<sup>[10]</sup>). Furthermore, the pass-through of tax cuts into consumer prices may be lower in times of constrained supply, as is the case today (Marion and Muehlegger, 2011<sup>[11]</sup>). Apart from reducing the effectiveness of government support, there may also be fairness concerns when tax cuts directly translate into larger profits for fossil fuels producers.

**Countries should therefore aim to support vulnerable populations through targeted income support, while developing alternative energy sources and transportation modes.** In contrast to price support, income support measures – e.g., temporary means-tested transfers – do not mute price signals, thereby encouraging energy savings and fuel switching, resulting in less GHG emissions while providing a financial lifeline to consumers (Pototschnig et al., 2022<sup>[12]</sup>; Bethuynne et al., 2022<sup>[13]</sup>).

**While income support still has a fiscal cost, better targeting of support measures can allow for a more sustainable policy response if high prices persist.** However, given that targeted interventions rely on government social databases to identify beneficiaries, some countries may face challenges in administering or implementing them in practice. First, in countries where social benefit systems are not very well developed or have a hard time reaching many of those potentially in need, e.g., due to high informality or lack of institutional capacity, targeting may be challenging. But even in countries where social benefits systems are more sophisticated, effective targeting would still require more than simply increasing existing transfers. Innovations in transfer mechanisms may be needed to ensure that groups that are most vulnerable to the energy price shock are reached. Digital delivery methods for transfers may be required, to bank accounts and via mobile applications, for example, especially in countries with high informality rates. These methods were used to target informal workers in emerging economies in particular during the COVID-19 crisis (OECD, 2020<sup>[14]</sup>).

**Evidence for Germany shows that existing social and fiscal systems are not entirely capable of addressing the additional burden of higher energy prices in a finely targeted way, and additional fine-tuned measures may be needed to avoid social hardship while limiting budgetary costs** (Kalkuhl et al., 2022<sup>[15]</sup>). The reason for such limited effectiveness is that existing systems do not account for the highly heterogeneous impact of price increases across households, which is driven by many factors. Income is one factor among others: the additional cost of higher energy prices is estimated to reach 6% of the overall consumption expenditure for the poorest decile compared with 2.8% for the richest groups (Kalkuhl et al., 2022<sup>[15]</sup>). Other factors, however, including housing location and quality, and household composition and access to energy and public transport all determine the degree of a household's financial vulnerability to energy price shocks (Flues and Thomas, 2015<sup>[16]</sup>; Blake and Bulman, 2022<sup>[17]</sup>). Therefore, as the case of Germany shows, support based on income alone may not be adequate.

**Targeting is also important when providing support to firms.** Governments should focus on companies that were previously solvent but are suffering from liquidity and solvency problems deriving

directly from the crisis (OECD, 2021<sup>[18]</sup>). Such approach will mitigate the risk of keeping inefficient firms alive, which could restrict competition, dampen domestic productivity growth, and even distort international markets (OECD, 2020<sup>[19]</sup>). However, support should be time-limited even as energy costs remain high, as firms will need to adapt over time. More generally, government support to firms should also be transparent, proportionate, and non-discriminatory (i.e., applying objective and transparent criteria for determining firms' eligibility) (OECD, 2020<sup>[19]</sup>).

**The unfolding energy crisis highlights social and political challenges of coping with energy price increases, similar to those anticipated as part of the transition to carbon neutrality** (ECB, 2022<sup>[20]</sup>; IEA, 2021<sup>[21]</sup>). In addition, persistently high energy prices resulting from the consequences of the war in Ukraine highlight that fossil fuels have become a less reliable source of energy, prompting concerns over energy security, particularly in Europe. In this new geopolitical context, synergies between climate policy and energy security policy should be exploited over the medium term, as pursuing the transition to carbon neutrality can help reduce dependence on fossil fuels. For this reason, interventions that blunt price signals and dampen incentives to reduce fossil-based energy use should be phased out while building capacity to better address household vulnerabilities to price shocks and accelerating the development of alternative sources of energy. This can be done, for instance, by supporting energy efficiency improvements and ensuring that networks and infrastructures are adapted to zero carbon technologies. Over time, investing in capacities for energy users to adapt their energy consumption and shift to alternative fuels should be a common priority for climate, energy, and social policies.

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## Notes

<sup>1</sup> The reason is that global refinery maintenance and capacity constraints are exacerbating dislocations caused by the war in Ukraine, thereby leading to tightened markets of petroleum products. See <https://www.iea.org/reports/oil-market-report-may-2022> for further discussion.

<sup>2</sup> This is not to say that nothing can be done. For instance, the IEA has designed a 10-point plan to decrease oil use by 6.2% within a four-month time window. See <https://www.iea.org/reports/a-10-point-plan-to-cut-oil-use>.

<sup>3</sup> The Special Feature is based on the OECD's policy brief [Why governments should target support amidst high energy prices](#) (OECD, 2022<sup>[4]</sup>).

<sup>4</sup> The Inclusive Framework jurisdictions covered by the data include all OECD countries, as well as: Argentina, Barbados, Benin, Brazil, Bulgaria, Burkina Faso, Cameroon, China, Croatia, Cyprus, Egypt, Gabon, Ghana, Gibraltar, Honduras, India, Indonesia, Isle of Man, Ivory Coast, Kazakhstan, Kenya, Morocco, North Macedonia, Pakistan, Paraguay, Peru, San Marino, Senegal, Seychelles, Singapore, South Africa, Thailand, Trinidad and Tobago, Ukraine, Uruguay, and Viet Nam. The 15 jurisdictions covered by the data that are not Inclusive Framework members are: Algeria, Bangladesh, Chad, El Salvador, Ethiopia, Fiji, Guyana, Lesotho, Madagascar, Moldova, Mozambique, Niger, Philippines, Tanzania, and Zimbabwe.

<sup>5</sup> The equivalent amounts in US dollars are: EUR 0.30 = USD 0.36; EUR 0.25 = USD 0.30; EUR 0.23 = USD 0.29; EUR 0.20 = USD 0.24; EUR 0.15 = USD 0.18.

<sup>6</sup> In the case of the Canadian province of British Columbia, an exemption from its provincial sales tax was introduced for the purchase of electric bicycles and tricycles.

<sup>7</sup> The fiscal cost of measures covering several years has been annualized. Estimates were provided by governments for a subset of 137 measures included in the database (from 32 countries).

<sup>8</sup> The total cost estimate is the aggregate of country-level estimations that can employ different methodological approaches, i.e., accrual vs. cash accounting. Additionally, price-based measures can have off-budget and below-the-line implications that are difficult to assess in the short run.

<sup>9</sup> This amount is extracted from the OECD Inventory of support measure for fossil fuels, which is a database that identifies, documents, and estimates more than 1 300 individual policy measures supporting the production or consumption of fossil fuels. It covers approximately the same countries as the database discussed in this Special Feature. See <https://www.oecd.org/fossil-fuels/> for more information.

<sup>10</sup> Patterns are the same when considering the number of measures included in the database instead of their fiscal cost. Income support measures account for 38% of all policies covered by the database, with

78% being targeted. Price support measures account for 62% of all measures and are largely non-targeted (77%).

<sup>11</sup> The amount provided through price support measures in OECD countries accounts for 65% of the total against 100% in non-OECD countries. Non-OECD countries covered by the database include Argentina, Bulgaria, Brazil, China, Indonesia, India, Romania, and South Africa.

