

SUBSIDIES FOR FOSSIL FUELS IN 2019

October, 2020

The study "**Incentives and Subsidies to Fossil Fuels in Brazil in 2019: Identify, Evaluate, Reform**", published by Inesc (Institute of Socioeconomic Studies), calculates the amounts of incentives and subsidies to production and consumption of fossil fuels in Brazil through a methodology developed by Inesc.

In Brazil, in 2019, such incentives and subsidies reached the amount of **US\$ 25,08 billion** (R\$ 99.39 billion). This represented 1.36% of the country's Gross Domestic Product (GDP) in 2019. In the same year, for example, this amount was equivalent to three years of the Bolsa Família Program (US\$ 7,6 billions - R\$ 33.1 billion in the 2019 budget) and to almost 29 times the total budget of the Ministry of Environment (US\$ 861,1 million - R\$ 3.44 billion in the 2019 budget).

This is the third edition of this study, and an increase in the amount of incentives provided to the sector compared to the previous year has been observed for the second time.

Why measure fossil fuel subsidies?

The topic is now of global importance, especially on the climate agenda. The burning of oil, gas and coal - which account for more than 80% of the global use of primary energy - is the main source of greenhouse gases that drive global warming. In this context, reforms on said subsidies becomes a strategic path to discourage the growth of production and consumption and detach growth from the use of fossil fuels.

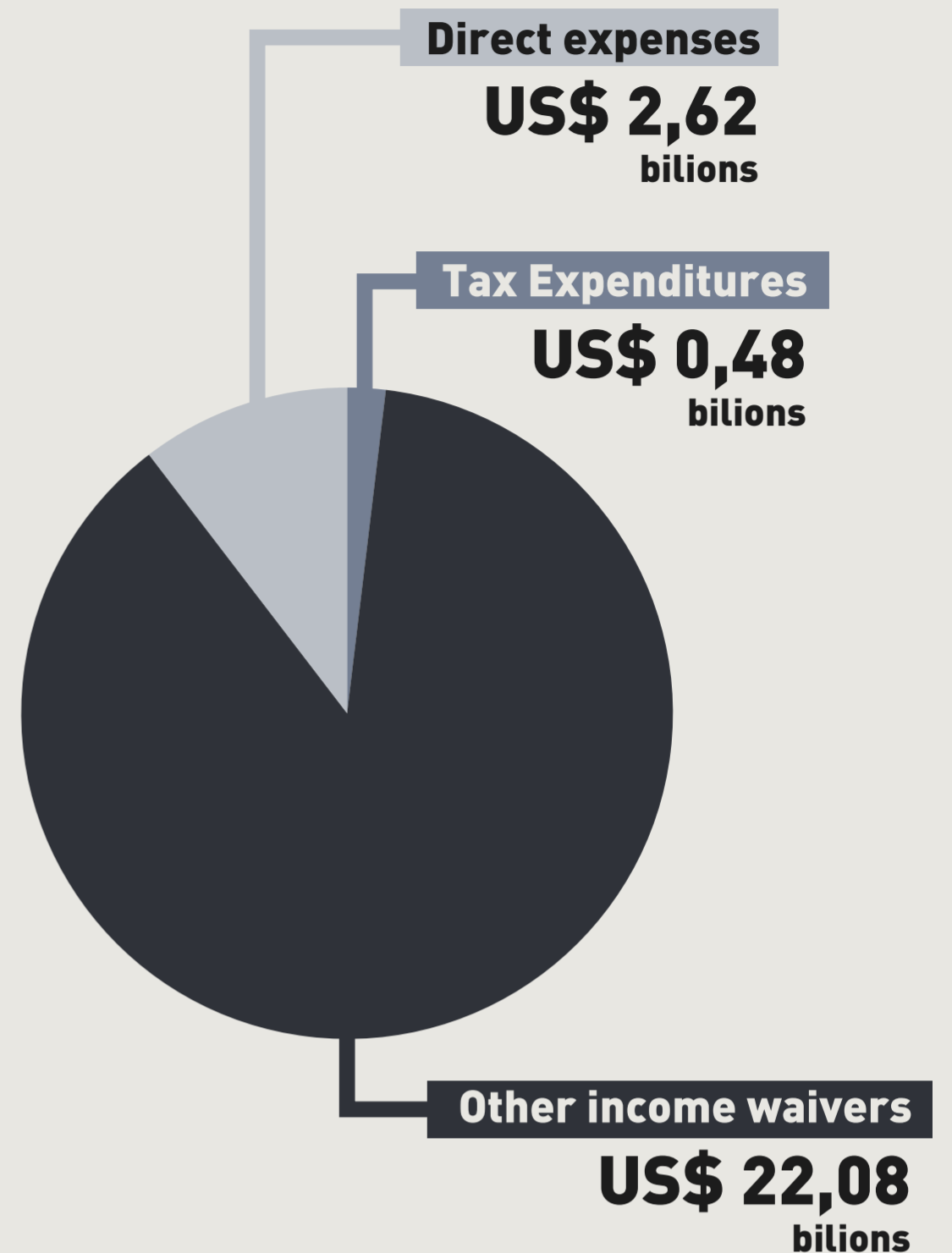
In addition, within the scope of the G20, Brazil made the commitment to reform such subsidies as part of a context of multilateral confrontation of the problem. According to estimates by the Organization for Economic Cooperation and Development (OECD) and the International Energy Agency (IEA), combined subsidies for consumption and production in 2019 came to US\$ 478 billion in 77 economies .

This issue must be disclosed to society and the government needs to recognize the need to measure, evaluate and reform such subsidies. Inesc has been monitoring incentives and subsidies as a way to instigate this debate, which is of central importance in view of the world scenario of inevitable and desirable energy transition and, in the Brazilian context, in the face of the deep fiscal crisis that has been affecting the country for five years.

Fossil fuel incentive categories

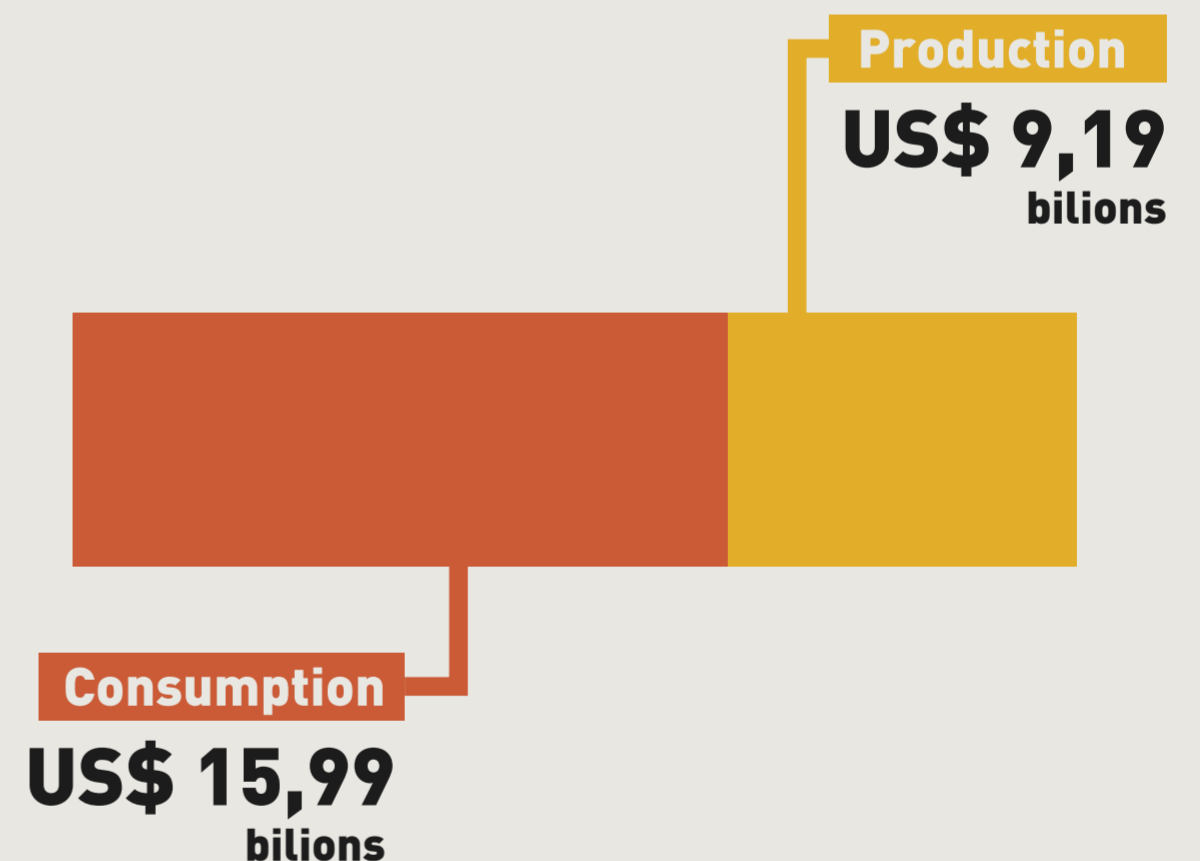
The document comprises data on 22 government incentives to the oil sector, including “Direct expenses”, “Tax expenditures” and “Other waivers”. The data were extracted and calculated using our own methodology, but based on official sources, mainly the Brazilian Federal Budget Panel, the Brazilian Federal Revenue Tax Expenses Statement and information received through Access to Information Laws (LAI - the Brazilian version of FOIA).

Most of these incentives and subsidies derive from the “Other Income Waivers” tax category, 87% or R\$ 87.14 billion, tax incentives that are not accounted by the Brazilian Federal Revenue as Tax Expenditures.



Fossil fuel incentive modalities

Most of the incentives in 2019 were granted to fuel consumption, through a reduction in the base for calculating taxes and contributions falling upon the consumption of gasoline and diesel fuel. Companies that operate in the Oil & Gas sector, including Petrobras, in turn, benefited from 36% of the incentives identified in the study.



It is important to mention that some of these incentives depend on the U.S. dollar exchange rates, in particular Repetro, a special tax and customs regime in which oil and gas prospection, drilling and refining companies are exempt from federal taxes regarding the purchase of imported equipment.

Such a regime would expire in 2020, but it was renewed until 2040, after intense public sector dialogues with stakeholders linked to the oil sector. This system was not only renewed, but it has also been expanded and renamed in recent years, with two different titles: Repetro-Sped and Repetro-Industrialização.

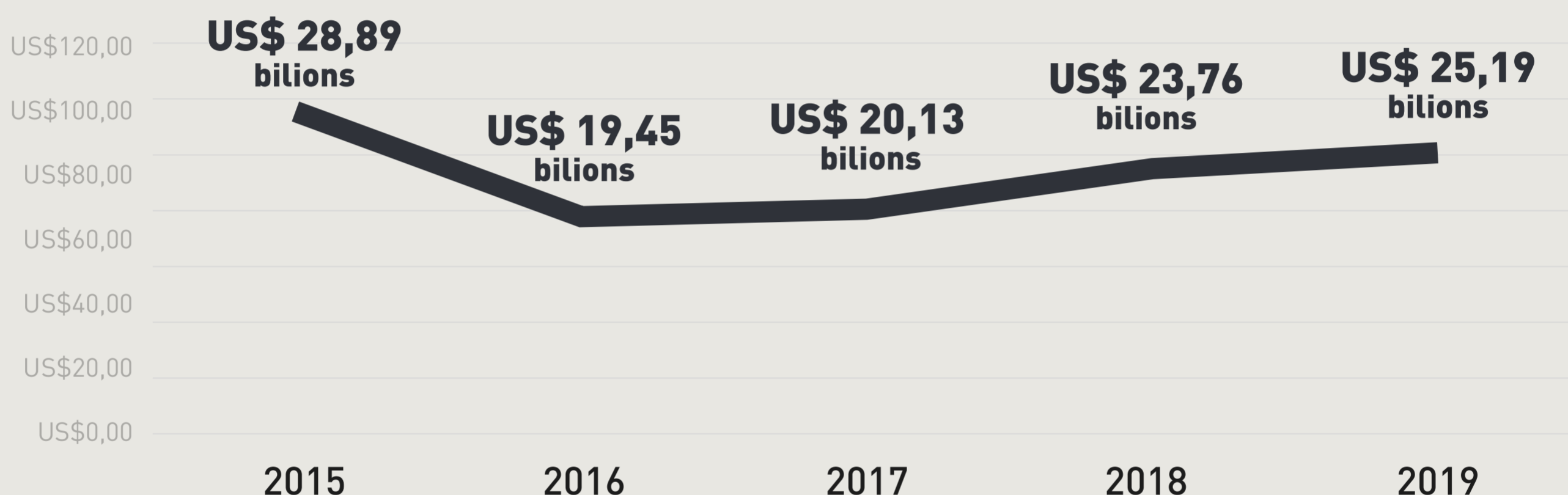
Other incentives to the sector, such as direct government spending, decreased in 2019 when compared to 2018. In summary, while some expenditures which are regulated and monitored by society decreased, such as direct expenditures - reflecting the government's fiscal crisis scenario - other less crucial incentives in the public's understanding decreased, such as tax waivers, amplifying the scenario of deep fiscal deficits in the country.

The behavior of incentives and subsidies over the past five years shows that they have been increasing in a concerning way in Brazil, and without serious discussions about their needs and implications.

Incentives to Fossil Fuels in the last five years

2015 a 2019

(current values in US\$ billion)



It is worth remembering that in 2018 and 2019, with the truckers' strike, a reduction in the calculation basis for diesel was again granted, which raised the waiver. Also, in 2018 and 2019 there was a significant increase in other waivers linked to production in the oil & gas sector, with the approval of the new Repetro (Repetro-Sped and Industrialização) and the increase in expenses that can be deducted from the basis calculation of Social Contribution on Profits (CSLL - Contribuição Social Sobre o Lucro Líquido) of legal entities opting for **Taxable Income**, pursuant to Brazilian Law No. 13,586/2017.

Taxable Income (Lucro Real, in Portuguese) is a tax regime in which the calculation of the Corporate Income Tax and Social Contribution on Profits (CSLL) is based on the accounting profit, calculated by the legal entity, plus adjustments (positive or negative) required by tax legislation.

Inesc's proposals for debate

In view of such significant numbers related to incentives and subsidies, and this complex and urgent challenge, we propose three central questions to guide the debate on incentives and subsidies in the Brazilian context:

The conceptual and normative challenges of assessing fossil fuel incentives and subsidies

It is strategical that the Brazilian government makes the necessary efforts to evaluate and review its subsidies, starting by presenting what is considered - among waivers, tax expenses and direct expenses - as incentives and subsidies to fossil fuels. For this to be done, the safest way would be peer review, a mechanism agreed within the scope of the G20.

Lack of data transparency

Within the scope of the executive branch of the Brazilian federal government, information on which companies are beneficiaries of the subsidies and with what amounts must be more transparent*.

Within the scope of the legislative branch, the law must allow the Brazilian population to know which companies benefit from tax exemptions and in what amount.

Complementary Bill 188/2014 has already been approved by the Brazilian Senate, which obliges the Brazilian Revenue Service to disclose which companies benefit from tax and contribution waivers. The bill must, however, be voted by the Chamber of Deputies.

The necessary connections between reform of waivers and subsidies, tax reform and the energy transition, on a global and national scale

Mitigating greenhouse gas emissions and stabilizing their concentrations in the atmosphere at a level that would restrain dangerous interference with the climate system is a challenge to be faced at both international and national scales. Without disregarding the high political and geopolitical sensitivity involving the production of fossil fuels, the debate to review subsidies as one of the ways to curb production is urgent. At the national level, this matter is linked to several urgent issues that are on the political agenda. One of those issues is tax reform. In this sense, the debate on the reform of incentives and subsidies should favor tax changes, in particular, the conversion of Cide-Combustíveis (contribution of intervention in the economic domain for fossil fuels) into Cide-Carbono (contribution of intervention in the economic domain for the carbon market) with broader application and incidence, respecting fiscal neutrality or the current tax burden. The fiscal issue is also critical. Subsidies mean that less resources can potentially be devoted to financing public policies that guarantee rights and that are central to stimulating a broad process of growth based on the energy transition.

*Although ordinances granting exemptions are published in the Brazilian Federal Official Gazette (DOU), they are dispersed over time and the waiver amounts by beneficiaries are protected by tax secrecy.

