GSI Global Subsidies Initiative

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RESEARCH REPORT

Following the Money: Fossil fuel subsidy reform en route from Durban to Rio+20

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Report on the high-level discussion "The Missing Piece? Climate Change Mitigation and the Benefits of Fossil Fuel Subsidy Reform," an official side event of the 17th Conference of the Parties to the UN framework Convention on Climate Change held on December 7, 2011 in Durban, South Africa

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About GSI

GSI is an initiative of the International Institute for Sustainable Development (IISD). GSI is headquartered in Geneva, Switzerland and works with partners located around the world. Its principal funders have included the governments of Denmark, the Netherlands, New Zealand, Norway, Sweden and the United Kingdom. The William and Flora Hewlett Foundation have also contributed to funding GSI research and communications activities.

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Following the Money: Fossil fuel subsidy reform en route from Durban to Rio+20
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"Following the money" was the quote of choice[1] in the most recent high-level debate on the possible pathways of the fossil fuel subsidy reform. The discussion, entitled *"The Missing Piece? Climate Change Mitigation and the Benefits of Fossil Fuel Subsidy Reform,"*[2] was an official side event of 17th Conference of the Parties to the UN Framework Convention on Climate Change in Durban, South Africa, and provided an excellent opportunity for the attending delegates to discuss not only the US$100 billion Green Climate Fund, but also the US$400–600 billion[3] worth of the governments' annual support to fossil fuels.

"We are talking something four to six times as large as the sum of money we are trying to get as a political agreement to combat climate change," stated Tim Groser, New Zealand Minister of Trade and International Climate Change Negotiations, in opening the discussion. "UNFCCC [United Nations Framework Convention on Climate Change] climate talks also aim at putting a price on carbon. But any decent analysis will tell you that it is incoherent to be putting a price on carbon and keeping subsidies for it at the same time, said Groser. "Our latest analysis[4]—highlighted in the March 2012 forthcoming *OECD Environmental Outlook to 2050*—shows that phasing out fossil fuel consumer subsidies in developing and emerging economies alone could lead to a 6 per cent reduction in greenhouse gas emissions in 2050 compared with baseline. The countries implementing the reforms would also realize economic efficiency gains," commented Simon Upton, Director of the OECD Environment Directorate, "and this is a very significant, albeit missing piece of the climate change puzzle."

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> Tim Groser, Minister of Trade and International Climate Change Negotiations, New Zealand

Prompted by the scarcity of public funds amid the ongoing financial and economic crisis, two of the world's largest economic blocs—the G-20 and Asia-Pacific Economic Cooperation (APEC)—committed to "rationalize and phase-out over the medium term inefficient fossil fuel subsidies that encourage wasteful consumption" in autumn 2009. Both the G-20 and APEC subsequently reconfirmed the commitment, including at the organizations' most recent summits in November 2011. However, the practical progress in the area of identifying and removing "inefficient" and "wasteful" subsidies has been slow.[5] In some areas, government support to fossil fuels even increased. According to Simon Upton, in their stimulus packages governments increased research, development, and deployment (RD&D) spending to "preserve the fossil fuel status quo" (including carbon capture and storage (CCS), etc.) by 323 per cent (from US$1.4 billion average per year between 2000–2008 to US$5.8 billion in 2009).[6]

[1] Originating from the 1976 film *All the President's Men*.

[2] The official side event was organized by the Friends of Fossil Fuel Subsidy Reform group of countries and the Global Subsidies Initiative (GSI) of the International Institute for Sustainable Development's (IISD) on December 7, 2011.

[3] Estimates vary depending on many factors, including the methodology employed and the world price for oil in a given year. There are three main components of the US$400–600 billion estimate. First, OECD estimates all types of fossil fuel subsidies in 24 of its member countries amount to the annual value between U$45 billion and US$75 billion. Second, according to the International Energy Agency (IEA), fossil fuel consumer subsidies in developing countries stood at US$409 billion in 2010. Third, the value of fossil fuel producer subsidies in non-OECD countries remains a "known unknown," but IISD puts the value of fossil fuel production subsidies worldwide at US$100 billion as a minimum.

[4] Using IEA data (2008 estimates) excluding land-use change emissions.

[5] Lang, Kerryn. (January 2011). *The first year of the G-20's commitment on fossil-fuel subsidies: A commentary on lessons learned and the path forward*. Geneva: IISD-GSI. Retrieved from: http://www.iisd.org/publications/pub.aspx?id=1407

[6] For comparison: RD&D spending on renewable energy systems and energy efficiency as part of stimulus packages increased by 100 per cent from US$3 billion on average per year between 2000–2008 to US$6 billion in 2009.

Proposed and Agreed Future Actions of Friends of Fossil Fuel Subsidy Reform as discussed at "The Missing Piece? Climate Change Mitigation and the Benefits of Fossil Fuel Subsidy Reform" official side event of UNFCCC COP 17 on December 7, 2011 in Durban, South Africa

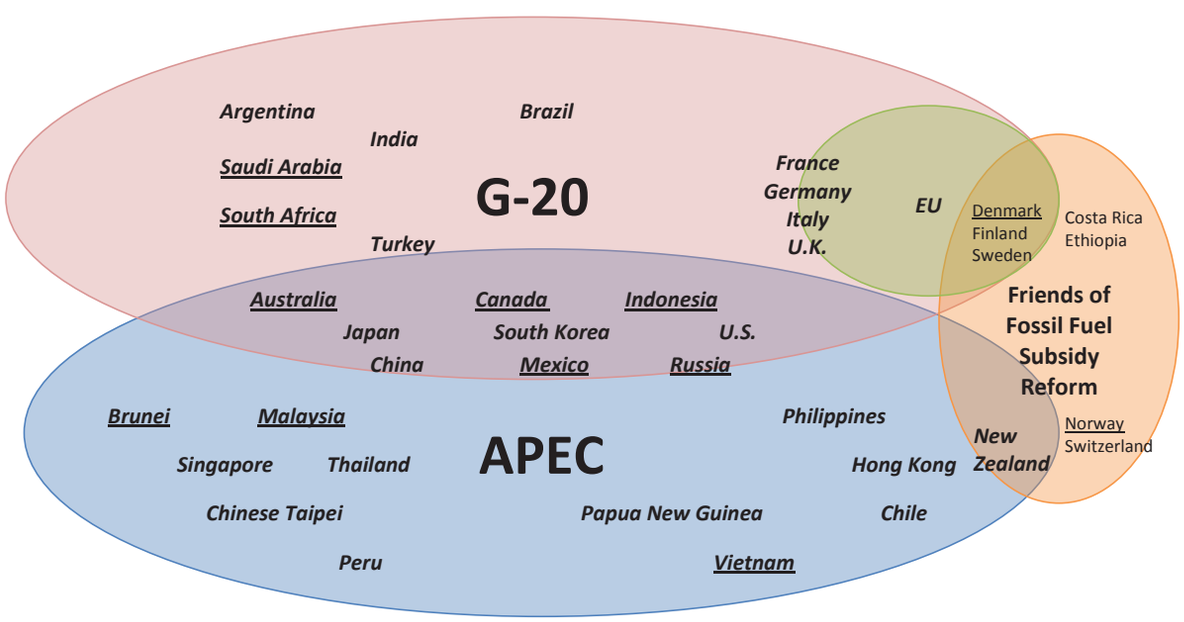
<table>
<tr><th colspan="2">International body / Action</th><th>UNFCCC</th><th>Rio+20</th><th>Friends of fossil fuel subsidy reform</th><th>OECD/IEA</th><th>APEC</th><th>G-20</th><th>WTO</th><th>Other international forums</th></tr>
<tr><td colspan="2">Raising political profile of fossil fuel subsidy (FFS) reform</td><td>Identifying FFS reform as a "missing piece" in climate talks and a possible "innovative source" of climate finance</td><td rowspan="5">Advocating FFS reform as a high-impact initiative as well as signing and promoting the National Pledge to Phase-Out FFS, a joint submission of IISD's GSI and 23 other civil society organizations</td><td>Increasing membership by including developing countries and larger states</td><td>Seeking progress in terms of FFS reform in OECD member countries, including against the OECD inventory</td><td>Calling for APEC's stronger action on FFS reform under its existing commitment, assisted by New Zealand's membership in APEC</td><td>Calling for G-20's stronger action on FFS reform under its existing commitment</td><td>Promoting WTO's positive experience in agricultural subsidy reform by applying it to FFS</td><td>Promoting FFS subsidy reform at all relevant international forums</td></tr>
<tr><td rowspan="3">Increasing FFS transparency</td><td>Introducing national reporting on FFS</td><td rowspan="2">Demanding compulsory FFS reporting under national communications as per New Zealand's submission to UNFCCC Secretariat</td><td>Voluntary development of FFS reporting to support phase-out of inefficient FFS in Friends group's countries</td><td>Advocating and expansion of independent OECD/IEA FFS inventories</td><td>Calling for implementation of the newly established mechanism for FFS reporting in APEC</td><td>Calling for better voluntary FFS reporting by G-20 nations</td><td>Calling for better FFS reporting under existing WTO mechanisms</td><td>Establishing an independent FFS international reporting function</td></tr>
<tr><td>Building up FFS-related research and improving methodologies of FFS identification, quantification and evaluation</td><td colspan="6">Promoting FFS-related research and information exchange in close cooperation amongst individual nations, OECD/IEA, WTO, World Bank, IMF and broader expert community, including on issues such as:
• Experience overcoming political economy challenges: incorporating private sector views and needs, designing social safety nets to mitigate negative impacts of the reform, developing effective public communications campaigns
• Prioritization of FFS reform by developing a typology that will identify the biggest, most inefficient, most harmful subsidies, possibly using a traffic light system used under WTO's agricultural subsidy work
• Modelling the impact of fossil fuel subsidies on green growth potential as well as impact of FFS subsidy reform in individual countries</td></tr>
<tr><td colspan="2">Facilitating exchange of information on FFS and best practices of FFS reform</td><td rowspan="2">Incorporating FFS reform into Nationally Appropriate Mitigation Actions (NAMAs) as per GSI's suggestion</td><td colspan="6"></td></tr>
<tr><td colspan="2">Channelling technical assistance from developed to developing countries to enable FFS reform</td><td>Providing FFS reform-related technical assistance and building capacity in developing countries</td><td colspan="5">Calling for international mechanisms to provide FFS reform-related technical assistance and build capacity in developing countries</td></tr>
</table>

The table includes both actions agreed by all members of the Friends of Fossil Fuel Subsidy Reform group and proposed actions subject to further discussion by the Friends.

Speakers left to right: Simon Upton, Tim Groser, Thomas Christensen, Doris Leuthard, Anders Flanking, René Castro

Front row left to right: IISD's David Sawyer and Franz Tattenbach

Speakers left to right: Peter Wooders, Simon Upton, Tim Groser, René Castro, Wondwossen Sintayehu



The Political Geography of the Global Fossil fuel Subsidy Reform.

Individual members of G-20 and APEC are marked in ***bold Italic***. Countries which were net exporters of energy in 2010–2011 according to the World Bank's World Development Indicators are underlined.

As an informal "ginger group," Friends of Fossil Fuel Subsidy Reform was launched in June 2010 "to get in behind the G-20 with a call for action" in the words of Tim Groser. The group has been growing organically, and to date includes eight small- or medium-sized developed and developing countries: Costa Rica, Denmark, Ethiopia, Finland, New Zealand, Norway, Sweden and Switzerland (see figure).

There are several reasons why the individual members of the Friends group have been proactive in the sphere of fossil fuel subsidy reform. The eight countries are resolute that fossil fuel subsidies currently represent, in the words of Doris Leuthard, Swiss Federal Counsellor and Head of the Federal Department for Environment, Transport, Energy and Communications, "lots of money which could be invested in more effective instruments" to address the existing policy objectives. "Energy subsidy reform is an issue on which the Ministry of Finance and Ministry of Environment are especially interested to work together in our country," said Anders Flanking, State Secretary to the Swedish Minister for the Environment. As Wondwossen Sintayehu, Director of Law and Policy Formulation Division of the Ethiopian Environmental Protection Authority said, "a hundred per cent of Ethiopia's fossil fuel consumption comes from imports, and that takes up more than 50 per cent of our foreign currency earnings. Putting budgetary support to fossil fuels—something alien—would be very much taking away the much desired resources from food security, health system, infrastructure."

> *"Putting budgetary support to fossil fuels would be very much taking away the much desired resources from food security, health system, infrastructure."*
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> Wondwossen Sintayehu, Director of Law and Policy Formulation Division, Environmental Protection Authority, Ethiopia

But fossil fuel subsidy reform is not restricted to fossil fuel importing nations and is "not intended as an attack on fossil fuels per se," as Tim Groser stressed, noting that New Zealand is an oil-producing nation, as are two other members of the Friends group, Norway and Denmark. "Norway is one of the biggest oil and gas exporters in the world as well as one of the biggest producers of hydroelectric power," explained Erik Solheim, Norwegian Minister of the Environment and International Development: "We want to be a responsible producer of all this and that is also why we have joined this club of like-minded nations." Tomas Christensen, Ambassador and Under-Secretary for Global Challenges in the Ministry of Foreign Affairs of Denmark, shared the Danish government's belief that green growth shows a path out of the economic crisis in Europe. "In that context, fossil fuel subsidies are blocking green growth potential, because they make investment in non-fossil energy/renewables unattractive," said Christensen, adding that, "Some developing countries end up paying two to three times for fossil fuels: the cost of buying, the cost of subsidizing and finally the missed opportunity of green alternatives being brought to the market." He also encouraged the OECD to analyze the negative impacts of fossil-fuel subsidies on green growth opportunities in developing countries.

Meanwhile, the "following the money" approach is merely preparing the ground for much more complex and comprehensive work at the international and national level to redesign the system of fiscal incentives to encourage low-carbon development. As all participants of the discussion noted, many governments are reluctant to phase out the subsidies out of fear of industry and general public protests. "Costa Rica has been reforming its energy subsidies for a long period of time, but still we haven't been able to touch the politically sensitive fuel subsidies to the fishing fleet," stated René Castro, Costa Rica's Minister of Environment, Energy and Telecommunications. "The political economy of one country may be very different from another, but the energy lobby in the United States might be comparable to the state-owned enterprise lobby in Vietnam," said Koos Neefjes, Policy Advisor Climate Change at UNDP Vietnam.

Given increasing demands on their budgets in the current austerity period, many governments are forced to undertake the phase out of fossil fuel subsidies only when they are left with no other choice, even though they may not be ready. Examples discussed included recent fully or partially unsuccessful efforts to remove fossil fuel subsidies in Bolivia, Indonesia, and Nigeria. In the meantime, as experience from Costa Rica, Ethiopia and some other countries testifies, negative social and competitiveness impacts can be avoided or mitigated if subsidies phase-out is well prepared, gradual and complemented by targeted support programs to the most vulnerable stakeholders. According to Wondwossen Sintayehu, in Ethiopia the success of the reform was creditable to a large extent to its gradual nature, whereby subsidies to fossil fuels were adjusted downward on a monthly basis over the course of one year.

All speakers at the side event were unanimous that advancing fossil fuel subsidy reform on the international agenda requires improved transparency of the existing fossil fuel subsidies in both developed and developing countries. Erik Solheim called for improving the available methodologies of subsidy quantification, classification and valuation. Simon Upton underscored that improved transparency also makes it easier to win the support of the general public for the reform, because "It would be much harder to subsidize inefficient fossil fuel subsidies if you had to do it in the full glare of daylight." Doris Leuthard referred to the positive experience of agricultural subsidy reform under the WTO, which was assisted by classification of subsidies into "boxes" depending on their negative impacts and, correspondingly, required reformatory response.

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> Organization of Economic Cooperation and Development

However, discussants differed on the point of whether or not reporting on fossil fuel subsidies by nations should be voluntary or obligatory, and if the latter is preferable, which international body could coordinate such reporting. In Tim Groser's view, "A full frontal attack on fossil fuel subsidies will not work," while a concerted unilateral reform by individual countries complemented by voluntary reporting presents more promise. Groser referred to the institution of such a voluntary mechanism for fossil fuel subsidy reporting for APEC at the organization's latest summit in November 2011.

In contrast, René Castro spoke in favour of an international legal framework to remove fossil fuel subsidies. He stressed that symmetrical international commitments alleviate the concerns of a particular country's losing competitiveness as a result of the fuel subsidy removal. Steve Kretzmann, Executive Director of Oil Change International, stressed that the UNFCCC can provide an ideal formal platform for the purpose by including fossil fuel subsidy reporting into the national communications, but unfortunately consideration of the respective proposal by New Zealand had been postponed beyond Durban.

In the meantime, there are more windows of opportunity for using the existing UNFCCC toolkit to promote fossil fuel subsidy reform. Several speakers pointed at the possibility of advancing fossil fuel subsidy reform as a non-market mechanism to reduce greenhouse gas emissions and incorporating it into Nationally Appropriate Mitigation Actions (NAMAs). This could channel some of the climate finance and technical assistance to benefit and co-benefit the design and implementation of fossil fuel subsidy reform in developing countries. In view of the "following the money" approach, "Fossil fuel subsidy reform should not be a missing piece or a secondary issue in climate change mitigation

and adaptation efforts. On the contrary, we should ask what climate-related mechanisms, in particular, NAMAs, can do for fossil fuel subsidy reform," suggested Franz Tattenbach, IISD President and CEO.

As a blueprint for further action, in November 2011 IISD's Global Subsidies Initiative also submitted a formal proposal to the Secretariat of the next UN Conference on Sustainable Development, Rio+20, to be held on June 20–22, 2012. Supported in total by 24 civil society organizations, the submission proposed that countries participating in Rio+20 pledge to:

1. Phase out fossil fuel subsidies that undermine sustainable development.
2. Assist other countries to phase out fossil fuel subsidies that undermine sustainable development.

> *The pledge for fossil fuel subsidy reform could be one of four—five high-impact initiatives at Rio+20 that can really make a difference."*
>
> *Peter Wooders, IISD Senior Economist*

"If you can think of one thing which represents inefficient use of public money, contributes to climate change and blocks development of renewable energy sources, that's fossil fuel subsidies," summarized Peter Wooders, IISD Senior Economist: "We therefore think the pledge for fossil fuel subsidy reform could be one of four—five high-impact initiatives at Rio+20 that can really make a difference generating carbon reductions as well as many other benefits and co-benefits, including fiscal deficit buy-down."

For a full transcript of the discussion "*The Missing Piece? Climate Change Mitigation and the Benefits of Fossil-fuel Subsidy Reform*" (December 7, 2011, an official side event of the UNFCCC COP 17 in Durban, South Africa) please contact: Ivetta Gerasimchuk at igerasimchuk@iisd.org or +41 22 917 8238.

Joint Submission to the UN Conference on Sustainable Development, Rio+20: A pledge to phase out fossil-fuel subsidies is downloadable at http://www.globalsubsidies.org/research/gsi-policy-brief-high-impact-initiative-rio20-pledge-phase-out-fossil-fuel-subsidies

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