



A High-Impact Initiative for Rio+20: A pledge to phase out fossil-fuel subsidies

Fossil-fuel subsidy reform has become an international priority. Already, 53 countries in the G-20 and APEC forums have committed to phasing out fossil-fuel subsidies over the medium term, and the European Commission (EC) is recommending that the reform of environmentally harmful subsidies be a priority for the Rio+20 Conference.

Rio+20—the United Nations Conference on Sustainable Development—is scheduled for June 4–6, 2012, and negotiating time is running short. Expectations are low that the conference will deliver a major new agreement or binding commitments. The International Institute for Sustainable Development (IISD) believes that an innovative approach is required to make Rio+20 a success.

The IISD recommends that Rio+20 focus on a few high-impact initiatives that will help create the enabling framework for sustainable development. A national pledge to phase out fossil-fuel subsidies will free up valuable fiscal resources that can be redirected to fund other sustainable development priorities, provide the opportunity to introduce more targeted measures to support low-income households, reduce greenhouse gas emissions and help incentivize investments in renewable energy.

RECOMMENDATION FOR RIO+20, JUNE 4–6, 2012

Countries should pledge to:

- 1. Phase out fossil-fuel subsidies that undermine sustainable development.**
- 2. Assist other countries in phasing out fossil-fuel subsidies that undermine sustainable development.**

Implementation of the pledges would be considerably strengthened by the adoption of supporting measures. It is recommended that countries commit to providing the following: transparent, annual reporting and review; technical and financial assistance for developing countries; common research and analysis; and Secretariat support.

The Global Subsidies Initiative is preparing a proposal for submission to the Rio+20 process. We invite other organisations to show their support by co-signing the submission. If you are interested, please contact: Kerryn Lang, klang@iisd.org +41 22 917 8920.



Why should countries phase out their fossil fuel subsidies?

Governments use fossil-fuel subsidies as policy tools to achieve objectives such as alleviating energy poverty, increasing domestic production, reducing living costs of the poor, or gaining political support. However, there are unintended consequences that come with their use: subsidies are generally **costly**; they **significantly increase global and local pollution**; and they are **socially regressive**.

SUBSIDIES ARE COSTLY

Fossil-fuel consumption subsidies distort market prices, creating a gap between the domestically subsidized price and the international market price. This situation has serious fiscal and economic ramifications for the country implementing the subsidies. Global fossil-fuel consumption subsidies amounted to US\$312 billion in 2009 and US\$558 billion in 2008 (International Energy Agency (IEA), 2010). These figures fluctuate depending on world prices, domestic pricing policies or shifts in energy demand. While being more difficult to measure, global producer subsidies are estimated by GSI to be US\$100 billion annually (GSI, 2010). Reducing or eliminating fossil-fuel subsidies would liberate scarce fiscal resources that could be redirected to fund other national priorities including the implementation of sustainable development commitments.

SUBSIDIES SIGNIFICANTLY INCREASE GLOBAL AND LOCAL POLLUTION

Fossil-fuel subsidies create incentives for higher levels of consumption, which in turn produce more local and global pollutants on behalf of both industry and consumers. Once implemented, these subsidies are difficult to remove; they thus prevent cleaner solutions from being adopted and move government policy in unsustainable directions. According to the IEA, a complete phase out of subsidies for fossil-fuel consumption would reduce CO₂ emissions by 5.8 percent, or 2 gigatonnes of CO₂, by 2020 as compared to business as usual. This will provide 40 percent of the reductions needed to move from the current policy's scenario to IEA's 450 ppm scenario, an energy roadmap which limits the global rise in temperature to 2°C (IEA, 2010). The Organization for Economic Co-operation and Development (OECD) estimates a 10 percent reduction in global CO₂ emissions by 2050, given the removal of fossil-fuel consumption subsidies (OECD, 2010).

SUBSIDIES ARE SOCIALLY REGRESSIVE

While fossil-fuel subsidies are often designed for the interests of poorer populations, they typically benefit medium- to high-income households or lead to diversion. This can be explained by ineffective targeting mechanisms, inadequate distribution schemes, and the fact that higher-income households consume more petroleum-based fuels. For example, in 2008 the Indonesian Ministry of Economic Affairs advised that the top 40 percent of high income families benefit from 70 percent of the subsidies, while the bottom 40 percent of low-income families benefit from only 15 percent of the subsidies (IEA, 2008). The IMF has found that, on average, over 80 percent of fuel subsidies benefit the wealthiest 60 percent of the population (Arze del Granado et al., 2010). Although low-income households typically receive a smaller share of the subsidies, they are disproportionately affected by subsidy reform. Subsidy reform policies need to include compensation measures for those consumers vulnerable to rising energy prices. This provides the opportunity to redirect subsidy savings to fund more targeted measures for supporting low-income households and other development priorities.



Subsidy reform is politically difficult—but possible

Good intentions often get trapped in the reality of political considerations: policy-makers fear that they will impoverish vulnerable parts of society or face strong opposition from interest groups who are benefiting from the subsidies: “Fixing the subsidy problem requires a political strategy that compensates powerful interests that consent to a change in policy—or finds a way to inoculate policy reforms against their opposition” (Victor, 2009).

Simply raising prices will not be enough to gain the necessary political support; packages of policies and supporting measures are required for successful reform. What should be included in these packages depends on the specific conditions at the country or local level. Increased health and education payments, investment in public transport, increased investment in access to modern energy services or cash payments are all options available to governments. There are a large number of potential packages and advocates for the various elements of these packages. For example, a local non-governmental organization (NGO) might advocate for health and safety measures, a trade union might want improved working conditions, or a more internationally focused NGO might link subsidy reform to increased electricity generation from renewables. Any or all of these solutions could form part of a final package acceptable to the various constituencies.

Navigating through the politics requires substantive consultation and negotiation to build support for the policy changes, which takes time. Subsidy reform is politically difficult, but country experience¹ shows it is possible.

Should producer subsidies be included in the pledge too?

Yes. It is counterproductive to subsidise the production of fossil fuels while at the same time trying to rationalize their use and promote alternatives. The G-20 countries clarified that producer subsidies were part of the commitment their members made in September 2009.

Again, political considerations are central. The main interest groups are not consumers but rather those who wish to see the industry strengthened; those who are interested in the extra jobs and economic output that increased production activity would entail and those involved in the wider production supply chain. The debate should be centred around whether increased production is good or bad for the economy: this should be viewed over the long and the short term, and include social and environmental considerations as well as impacts on the economy of depletion policy.

To have this debate, governments need information on the *scale* of producer subsidies and analysis of the *impacts* of these on a country.² An evaluation can then be undertaken as to whether the subsidies should, or should not, be retained: in more common parlance, whether they are “incentives” (in effect subsidies which have positive impacts) or are “subsidies” (i.e., subsidies with negative impacts).

¹ The GSI has published case studies on “Lessons Learned” from subsidy reform in Brazil, France, Ghana, India, Indonesia, Poland and Senegal. Available online: <http://www.globalsubsidies.org/en/research/reform>

² The GSI has developed an approach for identifying and measuring producer subsidies, outlined in two policy briefs [Defining Fossil-Fuel Subsidies for the G-20: Which approach is best?](#) and [A How-to Guide: Measuring subsidies to fossil-fuel producers](#) along with a [technical manual](#) on calculating subsidy estimates. This approach has been applied in three case studies for [Indonesia](#), [Canada](#) and Norway.



What about subsidies to other energy sources and technologies?

What we choose as our energy future will be vital to how sustainable our development is. Subsidies to nuclear, biofuels and renewables should also be estimated and evaluated against the policy goals they are designed to meet. Renewables will play a major role in any sustainable future energy system, and there are strong reasons to support them. Nevertheless, evaluating the performance of subsidies and reforming them to be more effective and efficient in meeting their policy goals would be a very useful exercise as the world moves towards a major scaling up of renewables-based electricity generation.

The proposed Pledge focuses only on fossil-fuel subsidies, but an alternative option could extend the scope of the pledge to cover all energy subsidies. A pledge to reform all energy subsidies would need to be supported by more research to understand the scale and impact of the subsidies for nuclear energy, biofuels and renewables-based electricity: the box below summarizes current knowledge.

NUCLEAR ENERGY

While the scale of support is unknown, it is generally accepted that the nuclear energy industry depends heavily on government subsidies. Phasing out these subsidies would compromise the competitiveness of a technology whose safety, security, and impact on the environment are highly debated.

BIOFUELS

Subsidies can be provided by governments at all stages of the biofuel production and consumption cycle, generally taking the form of market transfers, budget support based on production or consumption values, support to intermediate inputs and production factors, as well as research and development activities.³ According to the IEA, biofuels received around US\$20 billion in subsidies in 2009, mainly in the U.S., EU, Brazil and China (IEA, 2010). Depending on the specific policies countries have in place, the reform of biofuel subsidies could help reduce distortions in agricultural markets, prevent direct and indirect changes in land use and prevent crops from being diverted from food to energy markets.

RENEWABLES-BASED ELECTRICITY

Subsidies to renewables-based electricity often come in the form of mandates or portfolio standards, green certificate trading systems, feed-in tariffs and premiums, or investment and production tax credits. Subsidies are also common for the integration costs of renewables to the electricity grid (e.g. increasing storage capacity, subsidizing grid connections) and research and development. IEA figures for 2009 estimate that global government support for renewables-based electricity was equal to US\$36 billion and that an additional US\$5.6 billion of public and private money was spent on research and development for all renewable energy technologies (IEA, 2010). With this data, it is possible to deduce that the share of government spending on electricity-producing renewable technologies was between US\$1.68 billion and US\$2.52 billion. Like all subsidies, these policies can lead to perverse outcomes (e.g., favouring some renewable energy technologies at the cost of driving away investment from others that are equally as promising) or can be captured by powerful industry groups. Reform should focus on ensuring that the subsidies are achieving their policy objectives cost-effectively.

³ The GSI has published case studies estimating government support for biofuels in a number of countries including the EU and U.S. Available online: <http://www.globalsubsidies.org/research/biofuel-subsidies>



Working with other international processes to build momentum for subsidy reform

The G-20 and APEC commitments have helped to raise the political importance of subsidy reform and have led to increased activity, proposals and, in some cases, implementation at the national level.⁴ The recommended Pledge should complement and support these activities.

G-20 and APEC

In 2009, the G-20 announced a commitment to “rationalize and phase out over the medium term inefficient fossil fuel subsidies that encourage wasteful consumption” (Pittsburgh G-20 Summit, 2009). APEC members announced an almost identical commitment that same year (APEC, 2009). In total, 53 countries⁵ have now taken an international commitment to reform their fossil-fuel subsidies.

At the G-20’s Toronto Summit in June 2010, 13 members submitted implementation strategies and timelines for phasing out at least one of their fossil-fuel subsidies; seven declared their countries to have no inefficient fossil-fuel subsidies. While these appear to be positive developments on subsidy reform, two NGOs (Oil Change International and Earth Track) have identified major gaps and inconsistencies in each country’s reporting. The NGOs also noted that countries who claimed to have no inefficient fossil-fuel subsidies showed evidence to the contrary (Koplow et al., 2010).

At the G-20’s Seoul Summit in November 2010, Leaders reaffirmed their commitments to rationalize and phase out fossil-fuel subsidies, but on the country-specific level, only two members included subsidy reform in their policy commitments. There is still great need for the G-20 to act in order to fulfill their goals.

The G-20 Seoul Business Summit was attended by a group of global CEOs known as the “B-20” who expressed their support for the G-20 commitment calling for the removal of these subsidies within a five year period, which will “add to the efficiency and security of energy supply” (Seoul G-20 Business Summit, 2010).

Similarly, the Energy Working Group of APEC has committed to providing member countries with the research and tools they need to phase out fossil-fuel subsidies. They are currently conducting an analytical review and voluntary reporting on the subject over the medium term.

To support these commitments, a Friends of Fossil Fuel Subsidy Reform group of countries⁶ formed with the objective of promoting progress on subsidy reform by ensuring ambition and transparency in the G-20’s initiative.

A Rio+20 Pledge to reform fossil-fuel subsidies would extend the country coverage of these existing international commitments and could strengthen the reform efforts underway by providing a regular reporting mechanism and technical and financial assistance to support developing countries in reforming their subsidies.

⁴ A full timeline of progress towards subsidy reform by international forums can be found at: <http://www.globalsubsidies.org/content/timeline/>

⁵ The total includes G-20 members, including all the EU member states and APEC members.

⁶ The Friends group includes Costa Rica, Denmark, New Zealand, Norway, Sweden and Switzerland. More information can be found at: <http://www.globalsubsidies.org/research/event-gsi-presents-latest-fossil-fuel-subsidy-research-nz-launches-friends-reform-group>.



Working with other international processes to build momentum for subsidy reform (continued)

UNFCCC

Progress is also being made to include reporting on fossil-fuel subsidies in the United Nations Framework Convention on Climate Change (UNFCCC) process. The governments of New Zealand and Norway recently submitted proposals which recommend the release of information on the reform of fossil-fuel subsidies through National Communications. These are reports which both developed and developing countries must submit to the UNFCCC to show their progress on mitigating climate change. In addition, as the global allocation of funds for climate change mitigation and adaptation efforts is limited, redirecting fossil-fuel subsidies is seen as an “innovative source” of public finance (Kretzmann, 2011).

Countries could also implement policies and measures designed to phase out subsidies with the UNFCCC. The UNFCCC is a promising venue for furthering reforms on fossil-fuel subsidies because it has a large membership (194 countries) and a well-developed Secretariat. Developed countries could push for a common action on subsidy reform or support for it, or subsidy reform could be included in Nationally Appropriate Mitigation Actions (NAMAs). For developing countries, the NAMA route may allow for domestic subsidy reform policies and measures to receive technical or financial support from developed countries (IISD, 2010). IISD is actively engaged in developing NAMA options, including fossil-fuel subsidy reform.

The Pledge in detail

Fossil-fuel subsidy reform is dependent on a political process. The best solutions come about when there is a full public debate, undertaken transparently and with shared information. The detailed Pledge also includes supporting measures designed to encourage this debate.

COUNTRIES PLEDGE TO:

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

SUPPORTING MEASURES:

1. Reporting and Review

Countries commit to annual reporting of:

- a. **Prices** they charge each consumer group for each energy product. These reports should be delivered to an international organisation such as the IEA, a UN agency or another organisation experienced in collecting data.



- b. **Subsidies** they grant to fossil-fuel consumers and producers. Existing reporting mechanisms, such as the World Trade Organization's Agreement on Subsidies and Countervailing Measures (ASCM) or UNFCCC National Communications, are recommended for this process. More specific formats for reporting could also be used, such as those developed by the IEA (energy consumers) and OECD (energy producers and consumers).
- c. **Subsidy reform**, detailing the subsidies under reform, progress towards reform and the expected outcomes.

Countries should review progress against the commitment annually, using a peer review process or delegating to a third party such as an international organisation. All reports and reviews should be made public. Databases of energy prices, subsidies and subsidy reform should be developed and maintained.

2. Technical and financial assistance for developing countries

Technical and financial assistance may be needed to help governments improve their reporting of subsidies or to assist industries or consumers transition away from fossil-fuel subsidies. For example, assistance may be needed to establish a transparent pricing mechanism, design social safety nets (such as a cash transfer), finance cash transfers or restructure investment incentives. Technical and financial assistance can be provided directly or through organisations such as intergovernmental organizations and development banks.

3. Common research and analysis

While country-specific considerations are important, common problems are faced across the world, and solutions in one country can have generic application in many others. Setting up a common research and analysis program to support the Pledge initiative is proposed.

4. Secretariat support

Countries will investigate options for providing Secretariat support to countries. This is likely to include meetings of officials and expert groups to facilitate the exchange of information and best practices.

Getting the Pledge into the Rio+20 Process

The Rio+20 Conference is set for June 4-6, 2012. Two preparatory meetings have taken place, one in May 2010 and the other in March 2011, along with one intersessional meeting in January 2011. The final preparatory meeting is scheduled for May 28-30, 2012, while there remain two intersessional meetings on December 15-16, 2011 and March 26-27, 2012. These meetings are planned and organized by a 10-member bureau that was elected at the first preparatory meeting.

The objective of the conference is to "secure renewed political commitment for sustainable development, assess the progress to date and the remaining gaps in the implementation of the outcomes of the major summits on sustainable development, and address new and emerging challenges" (Rio+20, 2011). The themes of the conference will focus on a green economy and an institutional framework for sustainable development.



Getting the Pledge into the Rio+20 Process (continued)

Preparations for Rio+20 include collecting responses to a questionnaire on behalf of Member States, organizations of the UN system, financial institutions and other major stakeholders concerning their experiences with the themes of the conference. A synthesis report was compiled and presented to the second preparatory meeting, which outlined best practices and issues to be raised at the conference (UN, 2011). Submissions which supplement this report are still being accepted through the use of the questionnaire. Another avenue for introducing an issue to the Rio+20 agenda is through proposals by “major groups” (e.g. businesses, NGOs, farmers) which are due by November 1, 2011.

IISD is promoting a few high-impact initiatives to make the Rio+20 Conference a success. In the 2011 UNEP Green Economy Report, IISD outlined several key policy initiatives for governments to adopt as “enabling conditions” required for greening the economy (UNEP, 2011); these conditions include subsidy reform.

Recently, the European Commission has released its Communication to the European Parliament regarding the Rio+20 Conference and moving towards the green economy: “Rio+20 should launch a coordinated set of actions by countries to identify and phase out environmentally harmful subsidies, accompanied by targets and deadlines” (EC, 2011).

The Green Economy Coalition, a collection of environmental organizations, trade unions, research centres and consumer groups, also recommends that subsidy reform should be part of any Rio+20 agreement (Green Economy Coalition, 2011). WWF Russia and its partners see reform of subsidies that encourage exploration and development of hydrocarbons in fragile ecosystem of the Arctic shelf as a priority for Rio+20, whereas national level groupings such as Canada’s Green Budget Coalition have also stressed the importance of subsidy reform in federal budget decisions (GBC, 2011).

There are two parts to taking the Pledge forward: (i) submitting a proposal to the Rio+20 process by November 1, 2011; (ii) signing countries up to the Pledge.

Submitting the proposal

IISD will ensure that the Pledge is submitted as a proposal to Rio+20. Ideally the submission would be made jointly by a broad coalition of organisations, including those active internationally and nationally, as well as governments.

Signing countries up to the Pledge

Encouraging countries to sign up to the Pledge is an easy way to get involved and could form part of your organisation’s campaigning or influencing strategy. Existing forums, such as the G-20 or Friends of Fossil-Fuel Subsidy Reform group, should also be called upon to champion the pledge within the Rio+20 negotiations.

The Global Subsidies Initiative is preparing a proposal for submission to the Rio+20 process. We invite other organisations to show their support by co-signing the submission. If you are interested, please contact: Kerryn Lang, klang@iisd.org +41 22 917 8920.



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About IISD

The International Institute for Sustainable Development (IISD) contributes to sustainable development by advancing policy recommendations on international trade and investment, economic policy, climate change and energy, and management of natural and social capital, as well as the enabling role of communication technologies in these areas. We report on international negotiations and disseminate knowledge gained through collaborative projects, resulting in more rigorous research, capacity building in developing countries, better networks spanning the North and the South, and better global connections among researchers, practitioners, citizens and policy-makers.

IISD's vision is better living for all—sustainably; its mission is to champion innovation, enabling societies to live sustainably. IISD is registered as a charitable organization in Canada and has 501(c)(3) status in the United States. IISD receives core operating support from the Government of Canada, provided through the Canadian International Development Agency (CIDA), the International Development Research Centre (IDRC) and Environment Canada, and from the Province of Manitoba. The Institute receives project funding from numerous governments inside and outside Canada, United Nations agencies, foundations and the private sector.

About GSI

GSI is an initiative of the International Institute for Sustainable Development (IISD). GSI puts a spotlight on subsidies—transfers of public money to private interests—and how they impact efforts to put the world economy on a path toward sustainable development. In cooperation with a growing international network of research and media partners, GSI seeks to lay bare just what good or harm public subsidies are doing; to encourage public debate and awareness of the options that are available for reform; and to provide policy-makers with the tools they need to secure sustainable outcomes for our societies and our planet.

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