GSI Global Subsidies Initiative

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Side Event Summary

Fossil-Fuel Subsidy Reform: Building momentum at Rio and beyond

Monday, March 26, 2012

New Zealand's Permanent Representative to the United Nations in New York, **Ambassador Jim McLay**, introduced the side event and speakers. He explained that the session had been organized by the Friends of Fossil Fuel Subsidy Reform—a group of non-G20 countries, made up of Costa Rica, Denmark, Ethiopia, Finland, New Zealand, Norway, Sweden and Switzerland—to promote consensus around the benefits of reforming fossil-fuel subsidies. He explained that the goal of the Friends group is to expand support for reform of these subsidies, building on the efforts of the G-20 and other countries and groupings, such as Asia–Pacific Economic Cooperation (APEC).

The Ambassador reminded the audience about key statistics regarding fossil-fuel subsidies globally: in 2010, consumption subsidies are estimated to have been worth US$409 billion, and an additional US$100 billion may have been granted in subsidies to fossil-fuel producers. On average, fossil-fuel subsidies are likely to amount to between US$ 400–600 billion every year. These amounts represent a significant pressure at a time of fiscal constraint, and they largely benefit the middle classes. Only 8 per cent of subsidies in 2010 are thought to have reached the poorest. The subsidies also promote the use of fossil fuels, leading to increased greenhouse gas (GHG) emissions. It is thought that GHG emissions could be reduced by 10 per cent by 2050 if fossil-fuel subsidies could be reformed.

The Ambassador noted that reform of these subsidies is not new to the sustainable development agenda. In 2002, the Johannesburg Plan of Implementation from the World Summit on Sustainable Development mentioned the need to phase out harmful subsidies. In 2009, this was prioritized by the G-20 and APEC forums, which committed to phasing out inefficient subsidies that encourage wasteful consumption. The reform of harmful subsidies was also recently held up as one of the Aichi Biodiversity Targets for the Convention on Biological Diversity. As part of its Europe 2020 strategy, the European Union is also committed to reforming environmentally harmful subsidies.

He concluded that the zero draft of the outcome document for Rio+20 continues this trend by proposing a commitment on the reform of perverse subsidies. It is encouraging to see that among all the proposals being considered, there is clear recognition that the reform of subsidies must include provisions to protect vulnerable groups.

Ian Parry, Technical Assistance Advisor in the IMF's Fiscal Affairs Department, outlined the broad rationale for fossil-fuel subsidy reform and the basic elements of a reform policy. He began by explaining that the costs of externalities can best be internalized into market prices through a system of taxes on fossil fuels. These taxes are the most effective instruments for exploiting emissions reduction opportunities across the economy and promoting clean technology development and deployment. However, far from charging taxes to cover the costs of fossil fuels, many countries provide subsidies that reduce the cost of fuels to below market level. Therefore, before countries can introduce accurate pricing for fossil fuels, it is necessary to first remove subsidies.

Subsidies entail a large fiscal cost and are often inefficient at providing support to the poor because most of the benefits leak away to higher income groups. Any reform plan for subsidies needs to include compensation schemes that are carefully targeted (e.g., transfer payments for low-income households). The IMF suggests that subsidy reform be gradual and start with fuels that are least important to poor households. It also advises that governments might use price smoothing mechanisms to deal with energy price volatility, while limiting fiscal burdens over the medium term.

Christopher Beaton, from the International Institute for Sustainable Development's Global Subsidies Initiative (GSI), discussed the social impacts of fossil-fuel subsidy reform and what might be achieved on this issue at Rio+20. He explained that one of the primary motivations for reform should be to achieve more positive social outcomes: because these subsidies are a very inefficient social welfare policy, their removal can free up a large amount of resources that can be used to eradicate poverty and promote development more efficiently and effectively. A positive social outcome, however, is not guaranteed. Country experience shows that some countries adopt a simplistic approach and simply raise prices without taking into account the impacts on the poorest. In order to achieve progressive outcomes, a comprehensive reform strategy is needed, including complementary measures to protect the poorest, in-depth stakeholder consultation and full transparency.

The GSI hopes that high-impact outcomes on fossil-fuel subsidies can be achieved at Rio+20. While the zero draft text of the outcome document is positive, a more ambitious commitment could be made. In addition to committing to the reform of environmentally harmful subsidies, the GSI feels that the outcome document should commit specifically to the reform of fossil-fuel subsidies and the provision of assistance to developing countries attempting reform. These commitments should include a number of components that are important to implementation, namely: reporting on subsidies; providing financial and technical assistance; setting up a centre of excellence to draw together peer learning on subsidy reform; and, finally, a Secretariat to support these activities.

Ethiopia's Permanent Representative to the United Nations in New York, **Ambassador Tekeda Alemu**, presented Ethiopia's experience with reform. He explained that almost three years have now passed since Ethiopia abandoned its subsidies. This was done both as a matter of choice, given Ethiopia's aims for sustainable development, but also as a matter of necessity. Fuel subsidies were very costly, representing 50 per cent of total export earnings, contributing towards an increased trade deficit and curtailing investment in other development fields such as health and education. Since reforming subsidies, Ethiopia has seen a decline in the importation of kerosene and an increase in the use of electricity, as well as an increase in the use of biofuels produced from sugar cane.

Costa Rica's Ambassador for Climate Change and Global Environment Affairs, **Javier Dìaz Carmona**, presented Costa Rica's experience with reform. He explained that it has now been 20 years since Costa Rica reformed its fossil-fuel subsidies as part of an initiative to introduce taxes on fuel. Two thirds of tax revenues were committed to a national council on roads, which uses them to pay for the costs of maintaining and extending infrastructure.

The other third was paid into a national fund, the Fondo Nacional de Financiamiento Forestal (or FONAFIFO), that makes payments to the owners and possessors of forests and forest resources for the environmental services related to those resources, including their contributions to GHG mitigation, the protection of aquifers, biodiversity and scenic beauty. This mechanism has received significant support from governments and international organisations. Since its inception in 1997, payments have been made to the owners of 860,000 hectares of forest and forest resources, amounting to 16.8 per cent of the national territory. It has involved 10,000 families and had a real social impact. In addition, those responsible for more than 82,000 hectares of forests and forest resources near indigenous populations have received payments, amounting to an investment of US$21 million in these areas. Now that the program is in place, Costa Rica continues to innovate, having just introduced a credit transaction charge, a percentage of which also goes to FONAFIFO.

Sweden's Ambassador for Rio+20, **Staffan Tillander**, presented Sweden's experience with reform. He explained that, in contrast to the previous two case studies, he would present one where his country was still struggling with subsidies, despite the existence of a carbon dioxide (CO_2) tax. Since the 1970s, one of Sweden's key policy objectives has been to reduce its dependence on fossil fuels. For these reasons, a CO_2 tax was introduced in 1991, and succeeded in its purpose, as well as reducing CO_2 emissions. But at the time of creating the tax, there were concerns about the competitive disadvantages it might create for certain sectors. It was decided that special rules would be established for these sectors. Technically, this deviation from the normal taxation treatment is considered a "subsidy."

Recently, debate in Sweden has been asking: should we keep our exemptions? It has now been decided to gradually increase the tax levels for these sectors, such that by 2015 they will be charged 60 per cent of the tax level of other sectors.

Two points emerge from Sweden's experience: first, that reporting and transparency are vital. The Ministry of Finance annually reports on the lower level of taxes in different sectors, and the OECD recently published a report on fossil-fuel subsidies. When information is publicly available in this way, it is much easier to discuss what the optimal policy measure should be. Second, in Sweden, much was possible only because there was political consensus around the fact that there are many advantages to having highly priced fossil fuels.

Ambassador McLay thanked the speakers and invited questions from the floor. Discussion centered on:

- The need to identify hidden subsidies, as well as the more obvious ones.
- The G-20 agenda: it was commented that the issue of fossil-fuel subsidies has not been discussed by the G-20 since the Toronto Summit. Participants recognized that, while very valuable, the commitment that G-20 countries have made is a very challenging one, with the Friends group of countries existing in part to keep fossil-fuel subsidies on the agenda. One speaker suggested that reporting mechanisms could certainly keep momentum on the issue.
- Treatment of subsidies in the current negotiating text: among the changes that have been proposed to the zero draft of the Rio+20 outcome document, the G-77 have expressed their preference for deleting paragraph 126 entirely; it states, "We support the eventual phase out of market distorting and environmentally harmful

subsidies that impede the transition to sustainable development, including those on fossil fuels, agriculture and fisheries, with safeguards to protect vulnerable groups." Participants suggested that the clause may be particularly difficult to accept for oil-exporting countries. It was also suggested that G-77 countries are asking, "why are subsidies to only these sectors being singled out?"

- What governance structures are currently in place to help countries reform their fossil-fuel subsidies? It was discussed that no formal support currently exists for countries reforming their fossil-fuel subsidies, although there is ad hoc work being done on the issue by a number of international organisations and civil society organizations (CSOs).
- How can civil society help move the conversation along? Panel members emphasized the importance of transparency and openness, as well as building support for more countries to make commitments along the lines of the existing G-20 and APEC commitments.

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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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