OILCHANGE INTERNATIONAL

June 2010

Shifting Fossil Fuel Subsidies to Increase Energy Access and Support Climate-Affected Communities

I will work with my colleagues at the G-20 to phase out fossil fuel subsidies so that we can better address our climate challenge.

– President Barack Obama, September 22, 2009

Last year's announcements that G20 and Asia-Pacific Economic Cooperation (APEC) nations will phase out support for fossil fuels presents an important opportunity to redirect substantial portions of those subsidies into clean technologies that will alleviate energy poverty and support climate-affected communities. The concept is simple: stop funding the problem, start funding the solution.

Scale and Definitions of Fossil Fuel Subsidies

The amounts of money currently going to fossil fuels in wealthy countries – Annex 1 countries under the UN Framework Convention on Climate Change and/or members of the Organization for Economic Co-operation and Development (OECD) – alone would cover a significant amount of what is needed for climate finance (clean energy and adaptation needs) in developing countries. As seen in the box below, the current dollar amount of subsidies going to fossil fuels, as well as the definition of subsidy, is a matter of debate. This uncertainty highlights the need for transparency and an agreed reporting process.

Figure 1. Recent Global Fossil Fuel Subsidy Estimates

	Wealthy Country Subsidies (Annex 1 and OECD)	**Developing Country Subsidies (Non-Annex 1 and Non-OECD)**	**International Financial Institution and Export Credit Agency Subsidies**
G20 "IGO4" Report[i]	IGO4 study excludes OECD / Annex 1 subsidies.	$557 billion/yr (based on 2008 figures)	IGO4 study excludes IFI and ECA subsidies.
Estimates from Non-Governmental Organizations (NGOs)[ii]	$100 billion/yr $88 per capita	$400 billion/yr $54 per capita	At least $12 billion/yr
Notes	*Wealthy country subsidies are mostly producer subsidies, going to corporations. These estimates exclude military subsidies.*	*Developing country subsidies are mostly consumer subsidies, going to reduce energy costs.*	*These numbers vary annually because they are based on loans and project funding.*

The G20 have commissioned a report jointly authored by the "IGO4" – the World Bank, the International Energy Agency (IEA), the OECD and the Organization of the Petroleum Exporting Countries (OPEC). There are disagreements over the definition of fossil fuel subsidies and what should be quantified. The report focuses on consumer subsidies in developing countries, and currently excludes producer subsidies, such as subsidies to BP to conduct deepwater drilling. To ensure that key fossil fuel subsidies are removed, financing from export credit agencies and multilateral development banks should be included in the definition of fossil fuel subsidies that could be targeted for phase out.

Potential Emissions Reductions from Subsidy Removal

The elimination of fossil fuel subsidies would lead directly to greenhouse gas emission reductions. The G20 study estimates that the elimination of subsidies in 37 developing countries alone would reduce greenhouse gas emissions 6.9% by 2020. Higher emission rates and per capita subsidies in wealthy countries suggests that greater than 20 percent emissions reductions could be achievable if all subsidies (wealthy country and developing country) were removed.

Developing Country Support and Linkage to Climate Finance
Developing countries are legitimately concerned about access to energy for their populations, and the removal of fossil fuel subsidies can be seen as a threat to that access – unless the subsidy removal is accompanied by increased climate finance. For example, nine World Bank Directors representing 90 countries recently stated that the US Treasury's guidance note on halting Bank support for coal *"may have been acceptable if it had been accompanied by a US commitment to provide such enabling finance and technology".*[iii]

As the response to US Treasury's coal guidance note shows, non-Annex 1 countries are unlikely to agree to phase out subsidies in the absence of new and additional finance that can meet the energy needs of their populations. The key to the implementation of the G20 agreement regarding subsidy removal will be the provision of climate finance and the sequencing of the subsidy phase out.

Sequencing the Phaseout
To establish trust and build momentum, the subsidy removal should be phased, gradually decreasing the level of support, and differentiated by country income level. For example, wealthy countries could commit to phasing out energy subsidies completely within five to seven years, and those funds could be redirected to climate finance. Middle-income developing countries could aim for 10 years. Low-income countries could target a 50 percent reduction within 10 years and a complete elimination in 15 years.

This strategy offers benefits to all parties. Wealthy countries would take a significant step forward in reducing their emissions, while also producing needed funding for climate finance. Developing countries would benefit from reduced exposure to the fluctuations in the oil market as well as financial and technology transfers for mitigation. In addition, subsidy phaseout could become a central part of nationally appropriate mitigation actions (NAMAs) required of countries under the UNFCCC.

Support for Clean Energy Access and Climate-Affected Communities
From a policy perspective, it is important to note that actually shifting producer subsidies (which are often in the form of tax credits) and specifically redirecting them to international climate funds, including for adaptation, poses some technical and accounting challenges. In practice, the climate finance might have to be appropriated separately from the budget lines that eliminate the subsidies, or a new legislative vehicle could be created that both eliminates subsidies and redirects them to climate finance.

At the World Bank and other multilateral development banks, subsidy removal should be placed in the context of support for increased energy access for the poor and climate finance. This would mean:
- Prioritizing the energy needs of the millions of people living in areas not connected to the grid;
- Focusing on decentralized sustainable energy solutions that meet the energy needs of the poor in a cost-effective and energy efficient manner;
- Ending investments in fossil fuel extraction and use; and
- Shifting the portfolio of the development banks to be based on efficiency and renewables.

Unfortunately, the World Bank continues to be a leading source of support to fossil fuels. Unless that support changes, a growing international coalition will oppose the Bank's General Capital Increase.

Politics of Subsidy Shift
Shifting fossil fuel subsidies to fund energy access and climate finance is good politics, as well as good policy. Subsidy removal with increased climate finance quickly addresses the legitimate concerns that subsidy removal could decrease energy access. Developed countries can generate necessary trust and support from the developing world to secure a global clean energy transition by committing to improving energy access globally through renewables while phasing out fossil fuel subsidies domestically and via export credit agencies and development banks.

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[i] OECD, OPEC, World Bank and IEA Study June 2010. This study included 37 developing countries and is based on 2008 oil prices which were highest ever at over $90 / barrel. Abstract available at: www.iea.org/files/energy_subsidies.pdf

[ii] Based on Global Subsidies Initiative, IISD, Bank Information Center, ECA-Watch, Pacific Environment and Oil Change International estimates. The estimate of $100 billion in annual production subsidies in wealthy countries is also cited in the IGO 4 report.

[iii] http://priceofoil.org/wp-content/uploads/2010/02/wbdirectorresponsetotreasurycoal0110.pdf