

Shifting Fossil Fuel Subsidies to International Climate Finance¹

Secretary of State Hillary Clinton pledged to the world at the Copenhagen Climate Summit that “the United States is prepared to work with other countries toward a goal of jointly mobilizing \$100 billion a year by 2020 to address the climate change needs of developing countries.” In the same speech, Secretary Clinton spoke specifically about how this funding would be generated. She said, “We expect this funding will come from a wide variety of sources, public and private, bilateral and multilateral, including alternative sources of finance.”

Redirection of fossil fuel subsidies could provide substantial amounts of this finance. Building on the agreement at the G20 to remove fossil fuel subsidies, countries could further agree to redirect those subsidies towards clean energy, adaptation, and reducing deforestation. For years, fossil fuel subsidies have generated significant amounts of waste, drained national treasuries, and impeded the development of new markets in energy efficiency and renewables. Furthermore, as expressed by the World Bank Managers in their recent letter to the Treasury Department regarding the issue of coal, the transfer of funds from subsidies to the development of clean technologies would serve to build trust between developed and developing countries and would be met with broad praise.

The recent announcements that G20 and Asia Pacific Economic Cooperation (APEC) nations will phase out support for fossil fuels present an opportunity to redirect substantial portions of those subsidies into international climate finance. The concept is simple: stop funding the problem, start funding the solution.

Potential Revenue

The amounts of money currently going to fossil fuels in Annex 1/OECD countries alone (between USD \$57 billion and at least USD \$100 billion annually) would cover a significant amount of what is needed for international climate finance, and the elimination of these subsidies also would lead directly to greenhouse gas emission reductions in Annex 1/OECD countries. In the United States, shifting fossil fuel subsidies would generate at least USD \$10 billion dollars annually. An additional USD \$4 billion in subsidies annually is flowing to fossil fuel interests from U.S. taxpayers via the U.S. Export Import Bank, the Overseas Private Investment Corporation, the World Bank, and the regional development banks. These flows are technically ““off budget,”” but could be redirected by Executive Order and Guidance from U.S. Treasury.

Note that there is an additional USD \$300 to \$500 billion in Non Annex 1 subsidies to fossil fuels that exist mainly in consumer subsidies. While there are undeniable benefits to reducing these subsidies as well, this elimination should not be tied to climate finance, although it could be part of nationally appropriate mitigation actions (NAMAs). The need to sequence subsidy removal is discussed below.

¹ This briefing paper is excerpted from U.S. Climate Action Network, “Investing in the Future: Options for Climate Finance the U.S. Can Support.” Available online at: <http://blog.usclimatenetwork.org/wp-content/uploads/2010/05/investing-in-the-future2.pdf>

Diplomatic Reasons to Shift Fossil Fuel Subsidies

Internationally, the politics of ending fossil fuel subsidies are already intertwined with climate finance. Developing countries are legitimately concerned about access to energy for their populations, and the removal of subsidies can be seen as a threat to this unless it is accompanied by increased climate finance. For example, nine World Bank Directors representing 90 developing countries including the BASIC nations recently stated that the U.S. Treasury's guidance note on halting Bank support for coal "may have been acceptable if it had been accompanied by a U.S. commitment to provide such enabling finance and technology." In the same letter, Directors noted the ongoing support for fossil fuels in the U.S. as a reason to continue providing that support internationally. This explicit linkage between ending subsidies and providing climate finance is important, particularly in light of the World Bank's potential role as a key agency for climate finance.

Political Reasons to Shift Fossil Fuel Subsidies

As the Administration knows, there is tremendous amount of bipartisan public support for reducing fossil fuel subsidies, particularly to "Big Oil." In addition, as the controversy over a recent U.S. Export-Import Bank loan to Brazil for offshore drilling shows, continuing support for fossil fuel extraction abroad is a potential political liability. Linking subsidy removal with international climate finance is one of the most politically potent narratives for raising the necessary funding for climate finance. Finally, much of this finance can be accurately portrayed as building global markets for American clean energy technology and thus supporting green jobs and the clean energy economy.

How Can the U.S. Implement a Shift in Fossil Fuel Subsidies?

The President has already begun the process of subsidy removal (although not shifting) in his budget proposal by identifying almost USD \$4 billion annually in fossil fuel subsidies. This is a good start, but there is more that the Administration can do immediately to build momentum and political pressure on this issue.

- **Executive Branch.** The Administration can lead by example by shifting fossil fuel subsidies that originate in the Executive Branch. This includes U.S. support for all the multilateral development banks via Treasury, the U.S. Export Import Bank, the Overseas Private Investment Corporation, and other agencies of the Administration that subsidize fossil fuels. Doing this unilaterally will establish stronger diplomatic relationships, while putting pressure on those in Congress defending fossil fuel interests.
- **International development banks.** U.S. Executive Directors at Development Banks could be required to vote against any fossil fuel project (other than assistance with transition such as mine closure) that did not have as its sole purpose, energy poverty alleviation or energy access for the poor and where a full examination of all lower and zero carbon alternatives had not been undertaken.
- **Other G20 nations.** G20 nations could also be encouraged to phase out export credit and development bank support for fossil fuels.
- **Legislation.** Subsidy shift could also be part of an energy and climate bill in Congress, or advance as standalone legislation. Subsidy removal could be pursued through the budget process, but in the absence of a legislative linkage, would require a separate initiative on climate finance.
- **Presidential Commission.** Establish an independent Presidential Commission with multi stakeholder representation to identify and quantify subsidies to the fossil fuel industry. While this initiative should not slow initial actions towards obvious subsidy removal, it will be important moving forward to have full transparency and accounting for fossil fuel subsidies.

Perceived obstacles to Implementing a Subsidy Shift

- **Energy poverty.** The need to alleviate energy poverty and provide access to energy for the poor is perceived as an obstacle to phasing out international subsidies.
- **Gas prices in developing countries.** Rising gas prices in the developing world. Removal of consumer subsidies will by definition lead to higher gas prices.
- **Rising gas prices in the U.S.** Rising gas prices in the summer fuel industry and Congressional opposition to subsidy removal. “Big Oil” and their allies will cast subsidy removal as “new taxes” on the industry that will have to be passed on to consumers.
- **U.S. Congress.** Congressional opposition exists to any increase in international aid.
- **Technical issues.** Shifting domestic producer subsidies (which are often in the form of tax credits) and specifically redirecting them to international climate funds, poses some technical and accounting challenges.

Options for overcoming obstacles

Global sequencing and linkage. Eliminating subsidies to fossil fuels on its own is not adequate to establish trust and build momentum towards a global transition to a clean energy economy. The removal must be sequenced, and linked to climate finance. The most feasible solution would be a ongoing removal of fossil fuel subsidies, gradually decreasing the level of support, and differentiated in time and by country income level.

For example, Annex 1 countries could commit to phasing out energy subsidies completely within five to seven years, and that finance could in turn be redirected to climate finance. Middle-income developing countries could aim for 10 years, and 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:

- Annex 1 countries would take a significant step forward in reducing their emissions, while also finding needed funding for climate finance;
- Non Annex 1 countries would benefit from reduced exposure to fluctuations in the oil market as well as financial and technology transfers for mitigation. Subsidy phase out could become a central part of nationally appropriate mitigation actions (NAMAs);

In short, if implemented well, sequencing and linkage could address the first two perceived obstacles above.

Consumer protections and populist anger at “Big Oil’s” record profits. Subsidy removal in the U.S. should be accompanied by robust consumer protections in the form of windfall profits taxes and anti profiteering legislation. Potentially, dividend checks that could be part of climate legislation could be used to counter concern. Finally, the point can and should be made that redirecting money from subsidizing the oil industry to building the global clean energy economy is a politically palatable way to secure additional funds, even for international use.

Embed subsidy removal and climate finance in the same legislative vehicle. If subsidy removal and climate finance are separate initiatives, they both face steeper odds in Congress. The value of subsidies to the fossil fuel industry should be calculated based on revenue lost to the American taxpayer and cost of the service provided on the market (price gap).

Relevant Governance Implications for a Fossil Fuel Subsidy Shift

If the World Bank is to have any credibility as an agency responsible for climate finance, they must stop supporting fossil fuel projects in all cases where the sole purpose of the project is not energy poverty alleviation.