OILCHANGE INTERNATIONAL

HEINRICH BÖLL STIFTUNG
The Green Political Foundation

Fossil Fuel Subsidies, Climate, and the United Nations Framework Convention on Climate Change

By Oil Change International

ABOUT THIS PUBLICATION

This is an excerpt from: *Low Hanging Fruit: Fossil Fuel Subsidies, Climate Finance, and Sustainable Development* by Oil Change International for the Heinrich Böll Stiftung North America with contributions from the Vasudha Foundation (India) and Greenovation (China) - forthcoming in June 2012.

Published by the Heinrich Böll Stiftung
Washington, D.C., May 2012

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Fossil Fuel Subsidies, Climate, and the United Nations Framework Convention on Climate Change

Recent estimates of global fossil fuel subsidies for production and consumption are staggering, putting the total near US$730 billion annually[1] or higher. In a time of economic hardship, dangerous climate change, and growing demand for reliable and cleaner sources of energy,[2] these fossil fuel subsidies are a reckless and irrational use of taxpayer money and government investments.

Indeed, in 2009, G20 leaders recognized this, and committed to "phase out and rationalize over the medium term inefficient fossil fuel subsidies while providing targeted support for the poorest." A similar commitment was agreed at a subsequent Asia Pacific Economic Cooperation (APEC) Leaders meeting, which brings the total number of countries with such a commitment to more than fifty. However, progress towards meeting the goal of phasing out fossil fuel subsidies has been quite slow.

In January 2012, the UN Secretary General's High Level Panel on Global Sustainability (GSP) unequivocally called for the removal of these subsidies in their consensus report, "Resilient People Resilient Planet: A Future Worth Choosing." Co-chaired by the presidents of Finland and South Africa, the panel was comprised of major policy makers from 20 nations, including the European Union, United States, Brazil, India and China, the Russian Federation and others. The report recommends to "*phase out fossil fuel subsidies and reduce other perverse or trade distorting subsidies by 2020.*"[3]

Eliminating fossil fuel subsidies can free up finance needed for urgent mitigation and adaptation to climate change.

There are two important ways that a fossil fuel subsidy phase out can benefit the climate. First, elimination of fossil fuel subsidies, and thus a reduction in the production and consumption of fossil fuels, can contribute to closing the gigatonne gap that exists between current mitigation pledges and the level of emissions reductions needed to stay below 2°C, let alone 1.5°C.[4] Second, eliminating fossil fuel subsidies can free up finance needed for urgent mitigation and adaptation to climate change.

In the context of the United Nations Framework Convention on Climate Change (UNFCCC), three important avenues exist for pursuing these goals

1) Shifting Annex II (Developed Country) Subsidies to Provide Climate Finance;
2) Reporting on Subsidies under National Communications & Biennial Reports;
3) Increasing ambition for emissions reductions through subsidy phase out.

Each of these areas is examined below.

I. Shifting Annex II (Developed Country) Subsidies to Provide Climate Finance

While developed country governments are struggling to fulfill their promise of mobilizing US $100 billion a year by 2020 for climate mitigation and adaptation, much, if not all, of that money may be right in front of them. Fossil fuel subsidies in developed countries – specifically Annex II countries[5] under the UNFCCC – have particularly been targeted as a source of public climate finance contributions, including those to be channeled through the Green Climate Fund (GCF). Fossil fuel

subsidies in Annex II countries have the potential to be a significant source of climate finance, as their total may approach $100 billion a year.

Under the UNFCCC, developed countries have committed to providing funding for developing countries to transition from fossil-fuel-based economies to clean energy, climate resilient development pathways.

The UNFCCC and related agreements lay out some of the principles of climate finance, and, in addition, other important principles from environmental agreements and Parties' existing human rights obligations are instructive as the climate finance regime develops. The Heinrich Böll Foundation and others have identified some of the key principles relevant to the mobilization of climate finance:

- The measurement of the amount of public climate finance from developed to developing countries, the reporting of the amounts and flows of that finance, and the verification of those flows should be ***transparent and accountable***.
- The contributions towards climate finance should reflect the ***polluter pays principle ("common but differentiated responsibility")*** and ***respective capability*** of the country.
- Climate finance should be ***new and additional*** to current overseas development assistance and other pre-existing financial flows from developed to developing countries.
- The amount of climate finance should be ***adequate and precautionary*** in that it should be sufficient to keep global temperatures at a safe level.
- The flows of climate finance should be sustained in the medium and long term in such a way that the finance is ***predictable***.[6]

The scale of finance required – particularly to be 'adequate and precautionary' – is substantial, and may well outweigh current commitment levels. However, at present, countries have committed to supplying $30 billion in "fast start finance" for the period 2010 to 2012, and to scale up finance to $100 billion annually from public, private and innovative sources by 2020. The timeliness and scale of these commitments, as well as how they are managed, will be critical to ongoing negotiations under the convention, as they will reflect the level of trust between developed and developing countries.[7]

The Green Climate Fund (GCF), which was established at the 16th Conference of Parties in Cancun, is being developed as the main multilateral financing mechanism for climate finance. The GCF was envisioned as the key repository for the pledged long-term climate finance of $100 billion a year by 2020, although it is unclear how much money will be channeled through the Fund.[8] Regardless of how the money is channeled, however, the possible sources for the significant amount of resources pledged for climate finance, and the public portion of these funds, continues to be a hot topic of discussion.

The UN Secretary-General's High-level Advisory Group on Climate Change Financing (AGF) identifies a number of possible sources of climate finance, including:

- ***Public sources of finance***, such as revenues generated by removing fossil energy subsidies in developed countries, revenues from fossil fuel extraction royalties/licenses, revenues from carbon taxes, revenues from a financial transaction tax, revenues from the international auctioning of emission al-

lowances or the auctioning of emission allowances in domestic emissions trading schemes, revenues from offset levies, revenues generated from taxes on international aviation and shipping, revenues from a wires charge on electricity generation, or direct budget contributions;

- ***Development bank instruments***, such as resources generated via multilateral development banks using current balance sheet headroom (which could be used for climate finance but would not necessarily be considered new and additional), resources created via potential further replenishments and paid-in capital contributions, or potential contribution to a fund dedicated to climate-related investment financed through special drawing rights;
- ***Carbon market*** finance, or "transfers of resources related to purchases of offsets in developing countries"; or
- ***Private capital***, or "flows of international private finance resulting from specific interventions by developed countries."[9]

The report clearly shows that achieving $100 billion in climate financing by 2020 is an achievable goal – even if the numbers used by the AGF are absurdly low. In terms of fossil fuel subsidies, the report suggests that fossil fuel subsidies are between US$3 to US$8 billion in those Annex II countries, which are members of the G20 and assumes 100 percent of these resources are used for climate finance.

This low estimate is based on country self-reporting in the 2010 G20 report[10] from OECD, IEA, the World Bank and OPEC.

By comparison, an October 2011 OECD report that actually investigated tax codes found an order of magnitude more fossil fuel subsidies in these same countries in 2010, totaling more than $60 billion in 2010. This strongly suggests that there is potentially much more additional funding available from this finance source.[11]

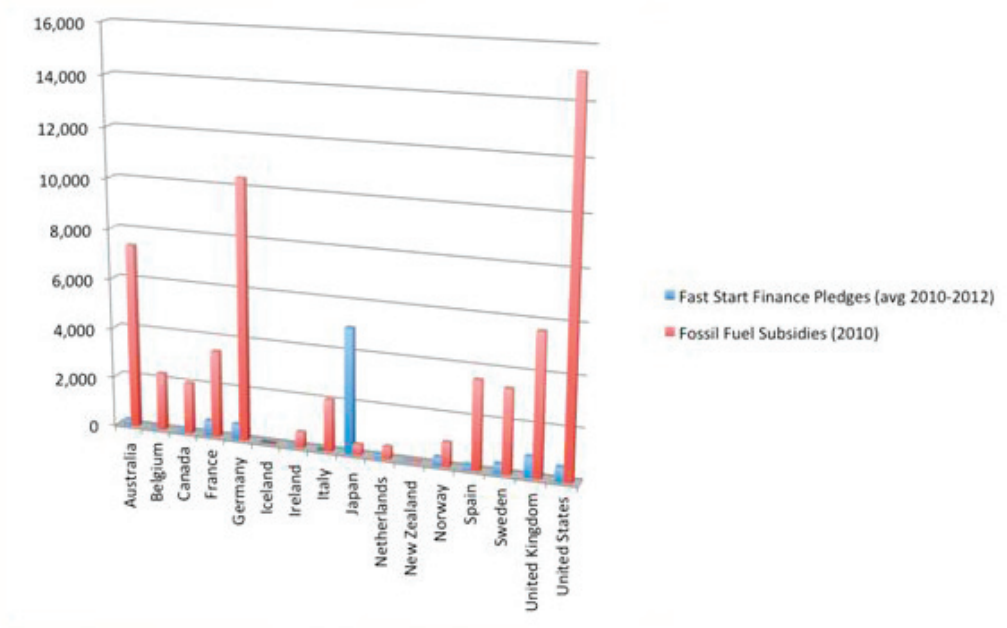
2010 Annex II Total FF Subsidies (in millions of USD)
Source: OECD, November 2011

Country	**2010**
Australia	7,356.31
Belgium	2,286.43
Canada	2,025.82
France	3,463.56
Germany	10,376.07
Iceland	0.00
Ireland	0.00
Italy	2,051.60
Japan	416.09
Netherlands	471.67
New Zealand	40.82
Norway	953.07
Spain	3,547.18
Sweden	3,335.47
United Kingdom	5,646.42
United States	15,087.32
Total	**62,683.19**

Fossil fuel subsidies in nearly all the countries that pledged fast start finance significantly overshadow the climate finance pledges.

Fossil Fuel Subsidies vs. Climate Finance Pledges: A Comparison of Key Countries
The combined country pledges for fast start climate finance from 2010 to 2012 approach the $30 billion that was originally proposed, although it is obvious that a significant part of these pledges are neither new money, nor additional to existing development aid, but often redirected development funding given in form of loans, not grants. However, the fossil fuel subsidies in nearly all the countries that pledged fast start finance significantly overshadow the climate finance pledges. For the countries where there is data available for both fossil fuel subsidies and fast start finance pledges, the existing fossil fuel subsidies total six times the fast start climate finance pledges.

Fossil Fuel Subsidies vs. Climate Finance Pledges for Annex II Countries (in millions of USD)[12]



The countries with the highest levels of fossil fuel subsidies – United States, Germany, and Australia – have generated only fractions of those amounts for climate finance. Japan is the only country with a higher climate finance pledge than fossil fuel subsidies, although it is important to point out that this pledge is based on data that is not transparent and is only a pledge, not yet paid.

II. Fossil Fuel Subsidy Reporting and National Communications in the UNFCCC

Under the UNFCCC, there is a need for specific and *transparent*, measuring, reporting and verification guidelines regarding the reporting of fossil fuel subsidies of all types by all Parties.

There is broad, high level political agreement on the need to eliminate both production and consumption fossil fuel subsidies. The G20 and APEC processes are ongoing, but to date have produced reporting of varying quality. Because the

UNFCCC has a Secretariat and a well functioning reporting arm in National Communications, it should be used to augment these existing processes in the interests of transparency.

However, basic transparency is lacking. An obvious first step to removing subsidies is to catalog *all* existing fossil fuel subsidies. Reporting and reform should be separate processes, in order to establish a clear understanding of where fossil fuel subsidies exist. Up to now, the disclosure of producer subsidies in particular has been lacking in many countries. It is imperative that governments commit to fully and fairly disclosing the existence and value of all fossil fuel subsidies to form the policy basis for informed, robust plans for reform. Fossil fuel subsidy reporting requirements in reporting guidelines should be part of:

- The revision of guidelines for the review of national communications for Annex I Parties;
- The revision of the common reporting format, in the interests of transparency and common understanding of national circumstances.
- The development of modalities and guidelines for… biennial reports as part of national communications from non-Annex I Parties.

It is imperative that governments commit to fully and fairly disclosing the existence and value of all fossil fuel subsidies.

As agreed, Non-Annex I1 Parties cannot be required to report on anything that Annex I parties do not. Cancun LCA Para 60, (a) states "The content and frequency of national communications from non-Annex I Parties will not be more onerous than that for Parties included in Annex I to the Convention". Therefore reporting of all types of subsidies should eventually be mandatory for all Parties to the UNFCCC, but with Annex I countries setting the best practice example.

In it's March 2011 submission[13] relating to a work program for the development of modalities and guidelines, New Zealand noted:

> *Improved transparency will also be an important element in helping countries demonstrate a complete picture of what climate change action is being taken at the national level. Measuring, reporting and verification (MRV) guidelines should encourage countries to include in their national reporting, actions taken primarily under other international commitments but which also have valuable mitigation benefits. One example is the reform of fossil fuel or energy subsidies. These reform commitments to phase-out inefficient fossil fuel subsidies have been made in the G20 and APEC contexts, but their mitigation potential creates clear linkages to the UNFCCC agenda. New Zealand would like to see progress in implementing related mitigation actions, such as progress in reforming fossil fuel subsidies, included as part of the transparency framework. Reporting on fossil fuel subsidy reform is also helpful from a domestic policy perspective as it clarifies for governments the cross-linkages and impacts between policies with different objectives, but which have mutually reinforcing outcomes.*
>
> *In order to facilitate comprehensive reporting, the guidelines should encourage reporting of action that might not have mitigation as primary objective but still have mitigation benefits. Reform of fossil fuel subsidies is one example in this regard.*

Reporting on the Existence of Subsidies

Where: National Communications

The status of fossil fuel subsidies should be reported on in a sub-section of a country's national circumstances, based on an agreed definition and common reporting format. As the purpose of reporting on subsidies should be to *simply increase transparency*, reporting under the national circumstances section is the most appropriate location.

The status of fossil fuel subsidies should be reported on in countries' National Communications, based on an agreed definition and common reporting format.

The current guidelines provide a great deal of flexibility for countries to report on their national circumstances, as is to be expected in light of the diversity amongst countries. That said, given the potential contribution to close the gigatonne gap that phasing-out of fossil fuel subsidies can make, it is clear that countries should, as a first step, start to report on the current status of their subsidies.

This reporting should be mandatory for developed countries and highly encouraged for developing countries. However, as G20 and APEC nations (a total of 53 countries, both Annex I and Non-Annex I) have already undertaken a firm commitment to phase-out fossil fuel subsidies, it is expected that *all* of those countries would report fully on current subsidies in their national communications.

Where: Biennial Reports

Under the Convention, developed countries committed to reporting on policies and practices which may lead to greater levels of emissions than would otherwise occur,[14] though reporting to date has been limited. In fact, expert review teams have regularly recommended that Parties consider the impact of certain policies and measures on increasing emissions in future reports. Clearly, if the world is going to have any chance of limiting warming to 2°C or 1.5°C and succeed in transitioning to a low-carbon future, consideration of measures counterproductive to such aims is prudent. That discussion is broader than the provision of fossil fuel subsidies alone; however its consideration should be central. Given their commitments since the adoption of the Convention, such reporting should be mandatory for developed countries and highly encouraged, as it will be beneficial for their own domestic planning purposes, for developing countries.

While updates of a country's national circumstances are not envisaged as part of the biennial reports, this does not mean that any changes to fossil fuel subsidies provided should only be reported every four years. Rather, if a country has started to phase-out its subsidies, reporting on such activities should be included in the discussion of its mitigation policies and measures (see section below on reporting on reform).

How: Agreed Definition & Common Reporting Format

Past reporting experience demonstrates that the only way to ensure comprehensive reporting from countries will be through agreeing on a common definition for subsidies and establishing a common reporting format and methodology. There is no need, however, to reinvent the wheel or to lose precious negotiating time on discussing possible definitions. The **WTO's definition of subsidies** already has broad support and should be incorporated into the reporting rules here, especially given the fact that all WTO parties are also parties to the UNFCCC.[15]

Reporting on Form of Subsidies

Where: Mitigation Actions section of Biennial Reports & Policies and Measures section of National Communications

Reporting on the phasing out of fossil fuel subsidies should be highly encouraged of all Parties, given its potential contribution to bridging the gigatonne gap. G20 and APEC countries have already committed to phasing out subsidies. While such commitments were made in other fora, their contributions to stopping climate change are clear and any specific actions taken to eliminate subsidies should, at a minimum, be reported on in the UNFCCC.

There is significant scope for the development of supported NAMA projects related to the provision of technical and financial assistance to support developing countries in phasing out their own fossil fuel subsidies. Reporting of fossil fuel subsidy reform by developing countries could occur in both the biennial reports and support NAMA reporting structures.

Developing countries are expected to produce Nationally Appropriate Mitigation Actions (NAMAs). Reform of existing consumer subsidies seems ideally suited to being described as a NAMA, and doing so could potentially entail financial and technical support to make subsidy reform politically possible. Such actions would be win-win for national budgets and the climate.

Fossil fuel subsidies increase greenhouse gas emissions.

In short, there are multiple paths forward for subsidy reform advocates in the UNFCCC. Because the Climate Convention has a Secretariat and a functioning reporting arm, it should be used to augment the existing processes in the interests of transparency. Subsidy reform is in fact too important an issue to leave to one institution. Its progress in any or all forums will require the engagement of country champions, and there is a thriving community of subsidy reform advocates ready and willing to support them in their efforts.

III. Closing the Gigatonne Gap with Subsidy Removal

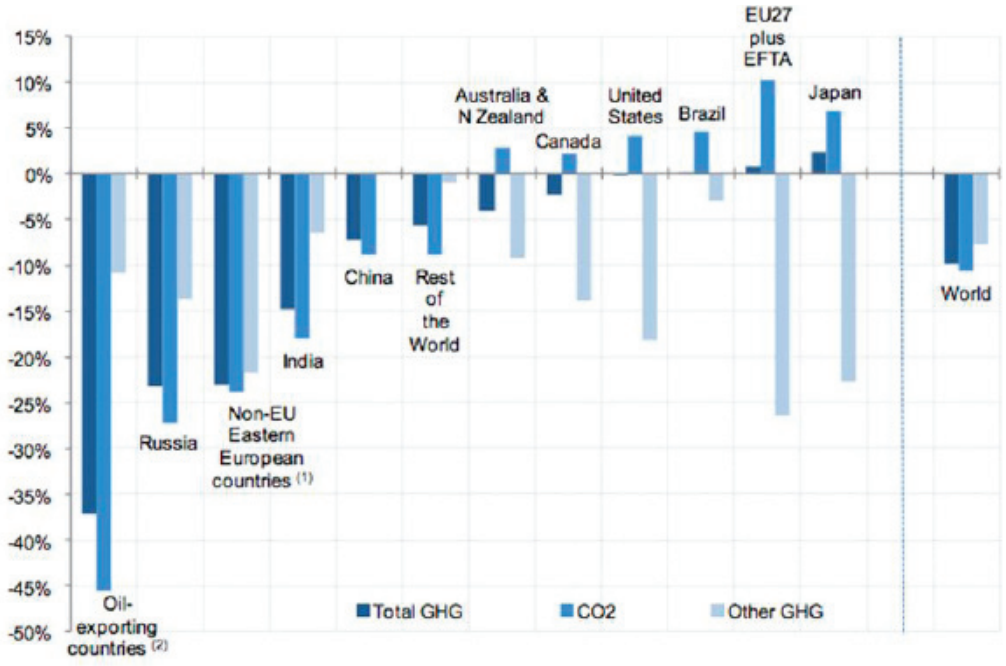
Fossil fuel subsidies increase greenhouse gas emissions. Analysis by the International Energy Agency (IEA) shows that phasing out subsidies to fossil-fuel consumption in the 37 largest developing countries could reduce energy related carbon dioxide emissions by 6.9% in 2020 compared to business as usual, or 2.4 gigatonnes.[16] These reductions alone would be roughly 40% of the reductions needed between now and 2020 to put the world on the path to 2 degrees by 2050.[17]

The IEA analyzed projections of three policy scenarios: the New Policies Scenario, the Current Policies Scenario and the 450 Scenario in its World Energy Outlook 2011. The 450 scenario is the only one that achieves an energy pathway with a "50% percent chance of meeting the goal of limiting the increase in average global temperature to two degrees Celsius (2°C), compared with pre-industrial levels."[18]

Fossil fuel subsidy removal is a key factor to place the world on the road to stabilizing the climate. The WEO 2011 states "removal of fossil fuel subsidies in the 450 Scenario accounts for a cumulative 7.9 Gt of abatement from 2010 to 2035, relative to the New Policies Scenario."[19] Again, it is important to remember that IEA is only modeling consumption subsidy removal in developing countries.

Additional analysis by the OECD of consumption subsidy removal in developing countries is revealing. As shown below, while the model used indicates roughly a 10% possible reduction in global greenhouse gases by 2050, it does project emissions actually increasing in many developed countries. This is a direct result of the fact that the impact of subsidy removal in developed countries, or producer subsidy removal in any countries, has not been modeled, to date.

Removal of fossil-fuel subsidies when emissions in OECD countries are capped. Impact on 2050 GHG emissions (percentage change from the baselines)



Source: OECD ENV-Linages using IEA fossil fuel subsidies data (IEA 2010).[20]

In the UNFCCC, over 110 countries' submissions have called for phase out of fossil fuel subsidies to be considered as a way to increase mitigation ambition.

Therefore, what this chart shows us is that information on the emissions reductions possible from fossil fuel subsidy removal is quite incomplete. This is precisely why transparency in the form of accurate and comprehensive reporting via a common reporting format and methodology is such an important requirement for this effort.

Important Progress Already

Even while increased transparency is still needed, countries have begun to recognize the emission reduction potential of eliminating fossil fuel subsidies. Ahead of the first negotiating session of 2012 under the auspices of the UN Framework Convention on Climate Change, Parties were requested to submit "views on options and ways for further increasing the level of ambition" under the newly created "work plan on enhancing mitigation ambition" within the Durban Platform for Enhance Action. Among these submissions, over 110 countries were represented in submissions that called for phase out of fossil fuel subsidies to be considered as a way to increase mitigation ambition.[21] This includes all members of the Least Developed Countries grouping, the Alliance of Small Island States, the European Union, New Zealand, Norway, Switzerland, and the United States.

All of these submissions specifically reference reform, removal, reduction or phase out of fossil fuel subsidies in some fashion as a means to achieve greater emission reductions. With such a large portion the most vulnerable countries to the impacts of climate change as well as a bulk of the wealthiest countries all converging on this potential source of additional emission reductions, it seems clear that this option should remain a live element of discussions in this forum.

The time is now to strengthen political commitments to fossil fuel subsidy phase out with action to begin the transition from dirty fossil fuels to a cleaner energy economy. Continuing to subsidize fossil fuels makes no sense given the need to greatly reduce our collective reliance on fossil fuels that are contributing to global warming. The steps described above represent critical initial, overdue elements of that transition, and civil society globally stands at the ready to support government efforts to implement deadlines for phase out, reporting and international support for effective fossil fuel subsidy removal.

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1 Fatih Birol, chief economist at the IEA, estimated that consumption subsidies in 2012 would be $630 billion, http://www.iea.org/weo/quotes.asp. An additional estimate of $100 billion in annual production subsidies is cited in the report commissioned by the G20 and prepared by OECD, OPEC, World Bank and IEA Study November 2010. Abstract available at: www.iea.org/files/energy_subsidies.pdf.

2 However despite this demand, in 2010 the IEA estimated global subsidies for renewable power at only $US44 billion as compared to the hundreds of billions in fossil fuel subsidies; IEA, World Energy Outlook 2011, p. 530.

3 Resilient People Resilient Planet: A Future Worth Choosing, Recommendation 27f., page 18, available at http://www.un.org/gsp/The GSP.

4 Article 2.1 of the Kyoto Protocol recognizes the contribution that the phasing out of fossil fuel subsidies can make to the achievement of developed countries' emission reduction targets.

5 Annex II countries of the UNFCCC include: Australia, Austria, Belgium, Canada, Denmark, European Economic Community, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom of Great Britain and Northern Ireland, and United States of America.

6 Schalatek, Liane. "A Matter of Principle(s): A Normative Framework for a Global Compact on Public Climate Finance." Heinrich Boell Foundation, 2011.

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10 G20. "Report to leaders on the G-20 commitment to rationalize and phase out inefficient fossil fuel subsidies." June 2010. www.g20.org/exp_04.aspx.

11 Original OECD report here: http://www.oecd.org/site/0,3407,en_21571361_48776931_1_1_1_ 1_1,00.html and here is a Spreadsheet with the numbers aggregated by Oil Change International: http://priceofoil.org/wp-content/uploads/2012/05/OECD-Country-Subsidies-01-25-12.xlsx.

12 OECD. http://www.oecd.org/site/0,3407,en_21571361_48776931_1_1_1_1_1,00.html#data and WRI. http://pdf.wri.org/climate_finance_pledges_2011-11-18.pdf.

13 listed in decision 1/CP.16, paragraph 46.

14 See UNFCCC Art. 4.2(e)(ii) and Annex I National Communication guidelines (FCCC/CP/1999/7) at para. 16.

15 See Article 1, Agreement on Subsidies and Countervailing Measures.

16 www.iea.org/files/energy_subsidies.pdf - Note that these numbers vary annually along with the price of oil, as they are linked to the value of consumption subsidies globally.

17 http://www.trucost.com/article/18/iea-calls-for-faster-scrapping-of-fossil-fuel-subsidies.

18 IEA/OECD, "World Energy Outlook 2011," page 55.

19 Ibid, page page 215.

20 Burniaux, J. and J. Chateau (2011), "Mitigation Potential of Removing Fossil Fuel Subsidies: A General Equilibrium Assessment", OECD Economics Department Working Papers, No. 853, OECD Publishing. http://dx.doi.org/10.1787/5kgdx1jr2plp-en.

21 A compilation of these submissions can be found at http://unfccc.int/resource/docs/2012/adp1/eng/misc01.pdf.

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