

## Policy tool



# #6

## Subsidies

### **Policy tool**

Unlock additional resources to assist climate action by reforming environmentally harmful support measures.

# #6 Subsidies



## What are subsidies and support measures?

Governmental support measures provide financial or other incentives to firms to promote certain outcomes. They can take different forms, including direct government expenditures, tax incentives, equity infusions, soft loans, government provision of goods and services, and price support. The WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) construes a subsidy as a financial contribution, income, or price support provided by a government or a public body which confers a benefit to its recipient. The Agreement regulates subsidies that are specific, i.e. the eligibility for which is limited to certain beneficiaries.

## How can reforming environmentally harmful support measures help mitigate climate change and promote sustainable trade?

Government support measures can be important policy tools to correct market failures and enhance social welfare. At the same time, if not well calibrated, they can distort production and trade, reduce economic efficiency, exacerbate negative spillovers, and cause damage to the environment and human health.

The potential for government support measures to exacerbate environmental degradation and impede the transition to a low-carbon economy has been widely discussed. This is relevant for sectors including in fossil fuels, hard rock mining, agriculture, fisheries, forestry, transport, water supply and consumption, and construction. A 2022 study estimates that the world is spending at least USD 1.8 trillion a year, equivalent to 2 per cent of global GDP, on subsidies that are leading to the destruction of ecosystems and species extinction (Koplow and Steenblik, 2022). According to World Bank estimates, subsidies for fossil fuels, agriculture and fisheries alone amount to USD 1.2 trillion per year in fiscal expenditures (World Bank, 2023).

While the impact of detrimental subsidies is cause for concern, reforming and repurposing subsidies could offer promising environmental benefits while freeing up scarce fiscal resources. The International Institute for Sustainable Development (IISD) estimates that reforming fossil fuel

subsidies by 2025 by rationalizing harmful subsidies would reduce CO<sub>2</sub> emissions by an average of 6 per cent by 2030. The IISD further estimates that reinvesting just a third of these savings into energy efficiency and renewable energy would add an additional 3 per-cent reduction in CO<sub>2</sub> emissions (IISD, 2022).

In the area of agriculture, the Organisation for Economic Co-operation and Development (OECD) has identified vast opportunities for reforms that could lead to lower GHG emissions while ensuring broad access to nutritious food, such as phasing out price support measures that could harm the environment and enhancing resilience towards extreme weather events. Such changes could also align the sector with climate goals. The OECD also recommends the introduction of an effective system that puts a price on GHG emissions coming from agriculture (OECD, 2022a).<sup>10</sup>

## Examples of support measures for climate action notified to the WTO

Since 2009, over 2,500 support measures adopted for climate action have been notified to the WTO by 78 members (EDB). The environment-related objectives of such support include afforestation/reforestation, air pollution reduction, alternative and renewable energy, climate change mitigation and adaptation, energy conservation and efficiency, and ozone layer protection.

Some recent examples include:

- Australia's Clean Technology Innovation Programme supporting the development of clean technologies to reduce GHG emissions;
- Lao PDR's profit, value added and other tax exemptions for energy efficiency investments;
- El Salvador's direct grants for reforestation and fruit tree diversification projects; and
- Mauritius's Bio-Farming Support Scheme increasing accessibility of farmers to organic inputs and promoting organic farming.

All of these studies suggest that phasing out and repurposing environmentally harmful subsidies could unlock substantial resources to support positive action on climate.

In any subsidy reform process, a variety of economic, trade and social considerations would come into play, including those related to a just and equitable transition to a low-carbon economy. There would also be potential challenges from vested interests as certain subsidy programmes were phased out ([IMF-OECD-World Bank-WTO, 2022](#)). Greater transparency and a deeper understanding of the flows of subsidies are prerequisites to ensuring effective and accountable reform. In addition, increased global cooperation and dialogue could have a positive role in preventing an inefficient “race” to subsidize environmentally positive, or “green”, technology, which could cause avoidable trade tensions, distort international competition, and disproportionately harm smaller, fiscally constrained developing economies.

### **What could be done to align support measures with wider climate action policy plans?**

A better understanding of the environmental impacts of existing subsidies and other support measures across all sectors would help to identify the priorities for reform in this area. In this context, careful design of any new subsidies could contribute to addressing the climate crisis while minimizing trade frictions and other potential negative spillovers. The environmental impacts of support policies and the possibility of repurposing them to support climate change mitigation and adaptation plans could be evaluated by governments.

WTO members have increasingly notified support measures for climate action (see box). Moreover, the WTO not only provides a forum to address and resolve trade-related challenges but also facilitates enhanced trade cooperation in support of sustainable development. Issues relating to improving transparency on subsidies, and evaluating the effectiveness of existing rules to address certain types of subsidies, are frequently raised by members in various WTO bodies, such as the General Council, the Committee on Subsidies and Countervailing Measures, the Committee on Agriculture, and the Committee on Trade and Environment ([IMF-OECD-World Bank-WTO, 2022](#)).

At the WTO Ministerial Conference in June 2022, trade ministers demonstrated the important role the WTO can play on subsidy reform when they reached a landmark agreement to curb USD 22 billion in annual public spending on harmful fisheries subsidies that encourage illegal, unreported, and unregulated fishing, fishing overfished

stocks and fishing in the unregulated high seas ([WTO, 2023a](#)). These are resources that can be put to better use. A second phase of these negotiations is ongoing to additionally reduce subsidies to overcapacity and overfishing.

Furthermore, two new plurilateral environmental initiatives at the WTO specifically address the environmental effects and potential reform of subsidies. First, within the [Trade and Environmental Sustainability Structured Discussions](#), participating members<sup>11</sup> are discussing how to identify the environmental and trade impacts of subsidies. They are reviewing existing information to better understand these impacts and potential information gaps and examining opportunities to address such impacts. Participants have deliberated on agricultural, fossil fuel, industrial and “green” or environmentally positive subsidies. These discussions aim to intensify work on areas of common interest, promote transparency, and identify concrete actions that members could adopt in an inclusive and transparent manner, taking into account the diversity of the membership and specific development needs.

Second, the co-sponsors of the [Fossil Fuel Subsidy Reform](#) initiative underway at the WTO are focusing their work on the comprehensive benefits — spanning trade, economy, society and the environment — of addressing fossil fuel subsidies and reallocating government funds towards green, climate-resilient projects. The participating members<sup>12</sup> have called for enhanced transparency on fossil fuel subsidies and for balancing developmental and social considerations during the reform of these subsidies. Participants have also discussed areas where the WTO could contribute to efforts to advance reform, including promoting good practices to ensure that fossil fuel support measures adopted during energy crises remain targeted, transparent and temporary in nature. Other efforts could include developing a deeper understanding of the classification of subsidies based on trade and environmental effects and enhancing subsidy transparency by making better use of existing WTO mechanisms.

Finally, some participants in the [WTO Dialogue on Plastics Pollution and Environmentally Sustainable Plastics Trade](#) have also raised the relevance of subsidies to virgin plastics (i.e. new materials that are often used to manufacture plastic products), in particular in the context of their effects on the competitiveness of potential effective and environmentally sustainable alternative plastics and non-plastic substitutes.

As the global community seeks to increase climate financing, especially to support developing economies’ quest for a just transition, repurposing environmentally harmful and market-distorting subsidies can be a win-win for people and the environment.