

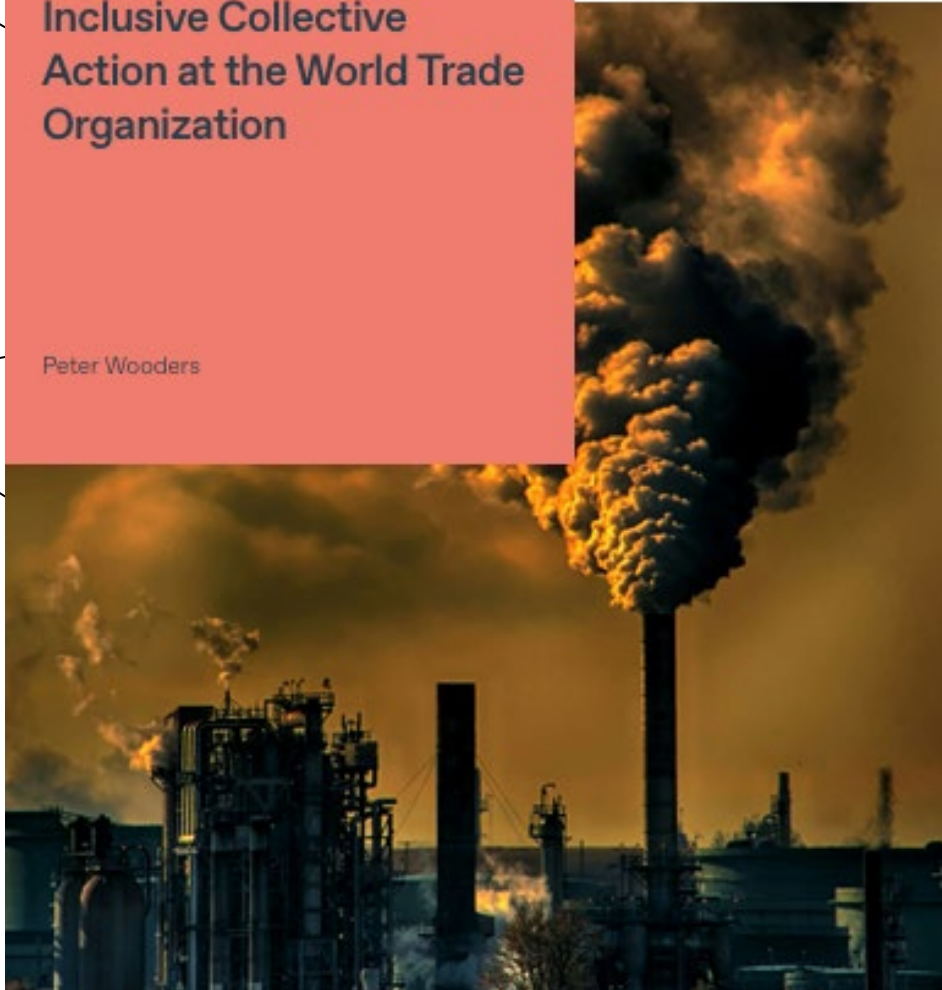
Policy Paper

April 2024

TESS Forum on Trade,
Environment,
& the SDGs

Fossil Fuel Subsidy Reform: Options for Inclusive Collective Action at the World Trade Organization

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28 May 2024

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WHY INTERNATIONAL COLLECTIVE ACTION?

Global fuel markets are generally highly competitive, especially for oil and petroleum products. Fossil fuel subsidies to producers and consumers distort these markets to the detriment of other producers and consumers

Energy markets are globally connected and the actions of one country, particularly a larger one, in increasing or reducing its consumption or production will affect all others. Ensuring security of supply is therefore a collective problem and actions to reduce consumption and price volatility in one country will benefit others

The impacts of energy use can be global, through GHG emissions, which drive climate change, but also through cross-boundary air pollution, which leads to acid rain for example. Rapidly phasing out fossil fuel development should be led by those countries that have historically benefited the most from fossil fuels and that have contributed the most to the increase of GHG concentrations in the atmosphere

Fossil fuel subsidies, and the challenges of reforming them, have many commonalities across the world. For example, all countries are concerned about the impacts on the poor and vulnerable as well as on strategic sectors if consumer FFS are reformed. Moreover, governments are also concerned about maintaining economic activity and security of supply if domestic fossil fuel production decreases

EXPECTED BENEFITS AND ADVERSE IMPACTS: CONSUMER SUBSIDIES

Expected Benefits

strong lower

Adverse impacts

strong lower

Note: The expected benefits and adverse impacts of FFS are qualitative, per unit of subsidy granted.
Source: Author's elaboration.

Generic Subsidy Type / Impact of Subsidy		Share of Global FFS (approx.)	Income	Mobility	Inflation Control	Health and Safety	Economic Activity	Security of Supply	Government Fiscal Space	GHG Emissions	Local Pollution	Production Liabilities	Corruption and Smuggling	Export Market Restrictions
Consumer	Make fossil fuels cheaper for transport	25%	strong	strong	lower		lower	lower	strong	strong	strong		strong	
	Make fossil fuels cheaper for other consumers*	55% (30% residential, 25% others)	strong		lower			lower	strong	strong	strong		lower	lower
	Increase energy access to modern fuels	minor (<5%)				strong	strong		strong	lower	lower			

* All non-transport consumers including residential, industry, commercial and public services, agriculture, and fishing.

EXPECTED BENEFITS AND ADVERSE IMPACTS: *PRODUCER SUBSIDIES*

Expected Benefits
■ strong ■ lower

Adverse impacts
■ strong ■ lower

Note: The expected benefits and adverse impacts of FFS are qualitative, per unit of subsidy granted.
 Source: Author's elaboration.

Generic Subsidy Type / Impact of Subsidy		Share of Global FFS (approx.)	Income	Mobility	Inflation Control	Health and Safety	Economic Activity	Security of Supply	Government Fiscal Space	GHG Emissions	Local Pollution	Production Liabilities	Corruption and Smuggling	Export Market Restrictions
Producer	Reduce costs to producers to encourage more production	15%-20% (of which 3/4 to extraction or mining, 1/4 to refining or processing)					strong	lower	strong	strong	strong	strong	lower	
	Support improved environmental performance**	minor (<1%)							strong	lower	lower			
	Support post-production costs**	minor (<1%)							strong	lower	lower	strong		
	Increase security of supply, across the fossil fuel system***	minor (<1%)						strong	strong	lower	lower			

**Both could also be included in first producer aim ("Reduce costs to domestic producers") as it can be argued that these costs should be borne by producers rather than government, and that government contributing to these costs encourages current producers to not make provision against them.

***Security of supply can be improved in many ways other than increasing domestic production, including non-technical options (e.g. labour relations). It is therefore included as a separate aim.

WHICH FFS HAVE THE LARGEST IMPACT PER UNIT OF SUBSIDY (\$)?

All universal FFS (i.e. non-targeted) are inefficient and regressive (i.e. more of the benefits accrue to wealthier consumers)

All FFS lead to overconsumption and therefore increased GHG emissions. FFS related to fuels with the highest GHG emissions per unit of energy (coal is higher than oil followed by natural gas) and those that are granted to low efficiency activities (e.g. coal-fired electricity generation) can be expected to have higher relative impacts

Coal has high adverse impacts across its uses, including in terms of local air quality, very high GHG emissions per unit of energy, and effects on local nature and populations

There is some evidence that the higher up the fossil fuel production supply chain, the greater will be the impacts in relation to increased production of fossil fuels

Air pollution is often one of the most significant causes of adverse impact. Fossil fuel activities which result in large amounts of pollution that affect the largest number of people have the highest relative impacts in this regard—for example emissions from transport, heating, or industrial facilities in built-up areas, especially when those activities lack emissions control equipment (e.g. filters) or where such equipment is poorly maintained

PRIORITY FFS FOR REFORM

This paper finds that 70% of global fossil fuel subsidies by value are granted to three categories: transport consumers; residential consumers; and producers of oil and gas. Major reduction of fossil fuel subsidies can only be successful if there is reform of these categories, which would free government budgets for other priorities such as poverty reduction, health, education, housing, tax cuts, boosting economic growth, or accelerating progress on clean energy. The high relative impacts of coal make coal subsidies a priority for reform. Governments in many countries also have an imperative to support consumers when prices are high and rising. This paper reviews recent experience of how to minimize the cost and duration of such support.

- *While it is important to focus on reforming these three largest FFS types, the fact that a subsidy is large does not automatically mean it should be eliminated*
- *However ongoing review, better targeting, and the progressive implementation of alternatives are indicated*
- *It is unrealistic to assume that all major FFS can be reformed immediately, or that all FFS can be reformed in parallel*
- *In jurisdictions where alternatives are less developed and where welfare systems and resources for mitigation are relatively weak, getting the reform process right will matter more, which may imply phasing planned reforms over a longer period*

REFORMING MORE MINOR (BY VALUE) SUBSIDIES

- The default approach should be to reform them (noting their adverse impacts)
- However, some of the more minor subsidies can have strong expected benefits and may also be politically sensitive. Such FFS would not be priorities for immediate reform and potentially include subsidies covering:
 - **Research activities**
 - **Assistance to disadvantaged regions**
 - **Adaptation of existing facilities to new environmental requirements**
 - **Reduction of GHG emissions or other forms of pollution**
 - **Support to poor, vulnerable, or remote consumers**
 - **Improving security of supply***
 - **Support provided after fossil fuel production has ended**
- Countries may wish to discuss how to deal collectively with subsidies within these categories

**Noting again that there are a wide variety of methods to improve security of supply and that greater security of supply is generally only a minor aim of increased domestic production of fossil fuels*

FFS REFORM: FIND ALTERNATIVES, BETTER TARGET WHAT REMAINS

1. Find Alternatives

Are there other ways of delivering the benefits of the subsidy (for example mobility or supporting incomes) **that would be cheaper** (lower the cost to government) **and that would result in lower adverse impacts** (ideally because alternatives are delinked from fossil fuel consumption or production)?

2. Better Target what Remains

If the subsidy is to continue at least partly, **how can it be better targeted towards the groups, sectors, or areas the policy is aimed to support?**

Targeting Options

Consumer

- Sector (e.g. transport, residential, industry)
- Fuel (e.g. LPG, electricity)
- Income (e.g. focus on poorest)
- Geographical area (e.g. remote or disadvantaged areas)

Producer

- Stage (e.g. exploration, refining, pipelines, storage)
- Fuel (coal, natural gas, oil)
- Specific categories of production (e.g. marginal fields)
- Geographical area (e.g. remote or disadvantaged areas)

DEVELOPING COUNTRIES FACE PARTICULAR CHALLENGES TO REFORM THEIR FFS

- **Generally, have larger parts of their populations and economies that are vulnerable** to rising prices or other disruptions
 - **Also tend to have lower public resources and less developed systems to provide benefits in alternative forms** (for example welfare payments)
 - **There are fewer private resources available for people and businesses to cushion themselves against shocks**
-
- Fiscal savings from reform tend to be highly valuable in developing country settings compared to developed countries, yet the need to protect the poor and vulnerable against the impacts of increased prices is often more critical in the former
 - Reform can therefore be expected to proceed more slowly in developing countries than in developed ones, as it may require the development of alternative mechanisms and targeting systems to provide welfare and cushion any adverse impact
 - Recognised in MC13 FFS Ministerial Statement, SDG 12.c, UNFCCC “CBDR”, etc.

THE WTO AS A NATURAL FORUM TO DISCUSS FOSSIL FUEL SUBSIDY REFORM

- **Broad membership** (covering more countries than for example the G7, G20, APEC, IEA, OECD, or the multilateral development banks) supported by their missions in Geneva
- As the **custodian of the SCM Agreement and the jurisprudence that has been built up** through a number of subsidy cases, the WTO is a natural forum for deliberations and rule-making on subsidies
- There is also **precedent at the WTO of designing international disciplines based primarily around sustainable development concerns**, for example through the recently concluded Agreement on Fisheries Subsidies
- **Subsidies are already addressed in a number of bodies and venues** including the Committee on Trade and Environment, the Committee on Subsidies and Countervailing Measures (SCM Committee), and the Trade Policy Review Mechanism (TPRM)

Options for Collective Action at the WTO on Fossil Fuel Subsidy Reform

Category of Collective Action	Recommendation For How Support at the WTO Could be Provided
Sharing problems, solutions, experience, and information	<ul style="list-style-type: none">■ Further develop understanding on how to identify and measure fossil fuel subsidies and produce national inventories, building contacts and collaborating with key organizations.*■ Investigate and develop options to increase transparency at the WTO and under other fora and processes, in collaboration with these fora and processes.■ Increase experience-sharing of reform challenges, solutions, and lessons, including around managing the impacts of reform on the most vulnerable groups and sectors of the economy. This should include a particular focus on reducing temporary support/emergency response measures as soon as possible and on devising and implementing plans to minimize fossil fuel subsidies when global prices increase.
Supporting the capacity to reform fossil fuel subsidies, following just transition principles	<ul style="list-style-type: none">■ Facilitate links between WTO members planning or undertaking reform—with a focus on developing countries—and key organizations able to provide support.

*Key organizations include the OECD, IEA, IMF, World Bank, EBRD and other multilateral development banks, international financial institutions, and non-governmental organizations including IISD's Global Subsidies Initiative and CEP (Council on Economic Policies).

Options for Collective Action at the WTO on Fossil Fuel Subsidy Reform

Category of Collective Action	Recommendation For How Support at the WTO Could be Provided
Enhancing coordination	<ul style="list-style-type: none">■ Improve coordination of the activities of organizations providing information and support to fossil fuel subsidy reform globally, and the WTO should liaise with other key organizations to improve coordination globally and regionally.
Assessing options for future cooperative arrangements	<ul style="list-style-type: none">■ Review and discuss how existing WTO rules apply to fossil fuel subsidies and how multi-country reform agreements could be formulated (including how to scope which subsidies could be included within an agreement and which should be prioritized for reform). A necessary part of such discussions will be to agree on how differences in levels of economic development could be included (e.g. special and differential treatment).■ A particular opportunity may be to instigate discussions and analysis around whether the zero taxation almost exclusively imposed on fuels used for international aviation and maritime transport could be increased.

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THANK YOU