

Increasing the Momentum of Fossil-Fuel Subsidy Reform: A Roadmap for international cooperation

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1.0 Executive summary

The practice of subsidizing fossil fuels is increasingly recognized as being incompatible with efforts needed to address climate change and develop sustainably. Removing subsidies for fossil fuels has further benefits at the national level; notably, reduced government spending on fossil fuels can help relieve fiscal burdens during times of economic crisis and free up resources for spending on other priorities. While many of the actions will be at the national level, international collaboration and agreement can support national efforts regarding research and technical assistance, sharing of information and best practice, establishment of rules, financial support, and through increased accountability.

But where should this international collaboration and agreement be housed?

The World Trade Organization's (WTO) Agreement on Subsidies and Countervailing Measures seems the obvious first choice; however, the WTO's established subsidy disciplines, reporting mechanism and Dispute Settlement Body have not comprehensively addressed fossil-fuel subsidies to date—due, in part, to its trade-focused mandate and the lack of political will on the part of its members to address energy trade issues. As the membership expands to include more energy-producing countries and as energy security and climate change become higher national priorities, the calls for addressing fossil-fuel subsidies more comprehensively within the WTO may increase. This will necessitate negotiating new subsidy disciplines that address the economically distorting and environmentally harmful nature of fossil-fuel subsidies. It is not politically feasible to progress this during the Doha Round of negotiations, but increased efforts to advance research, technical analysis and awareness raising will pave the way for incorporating fossil-fuel subsidies into the agendas of future rounds of multilateral trade negotiations.

The UNFCCC (United Nations Framework Convention on Climate Change) is another obvious choice. It has comprehensive membership and a well-established secretariat and schedule of meetings; climate change is one of the key rationales for fossil-fuel subsidy reform. Although subsidy reform is mentioned within the text of the UNFCCC and its Kyoto Protocol, no serious initiatives or discussions to reform subsidies have as yet been held. Further, the UNFCCC has always strongly upheld the principle of national sovereignty and has made little attempt to agree on lists of policies and measures that countries should undertake. Legally binding commitments to fossil-fuel subsidy reform thus seem highly unlikely in at least the medium term, particularly given the fundamental discussions on the future direction of the UNFCCC, which are currently (2010) underway. The UNFCCC could, however, support voluntary and nationally focused efforts. For developed countries, the UNFCCC could advise those countries that actions regarding fossil-fuel subsidy

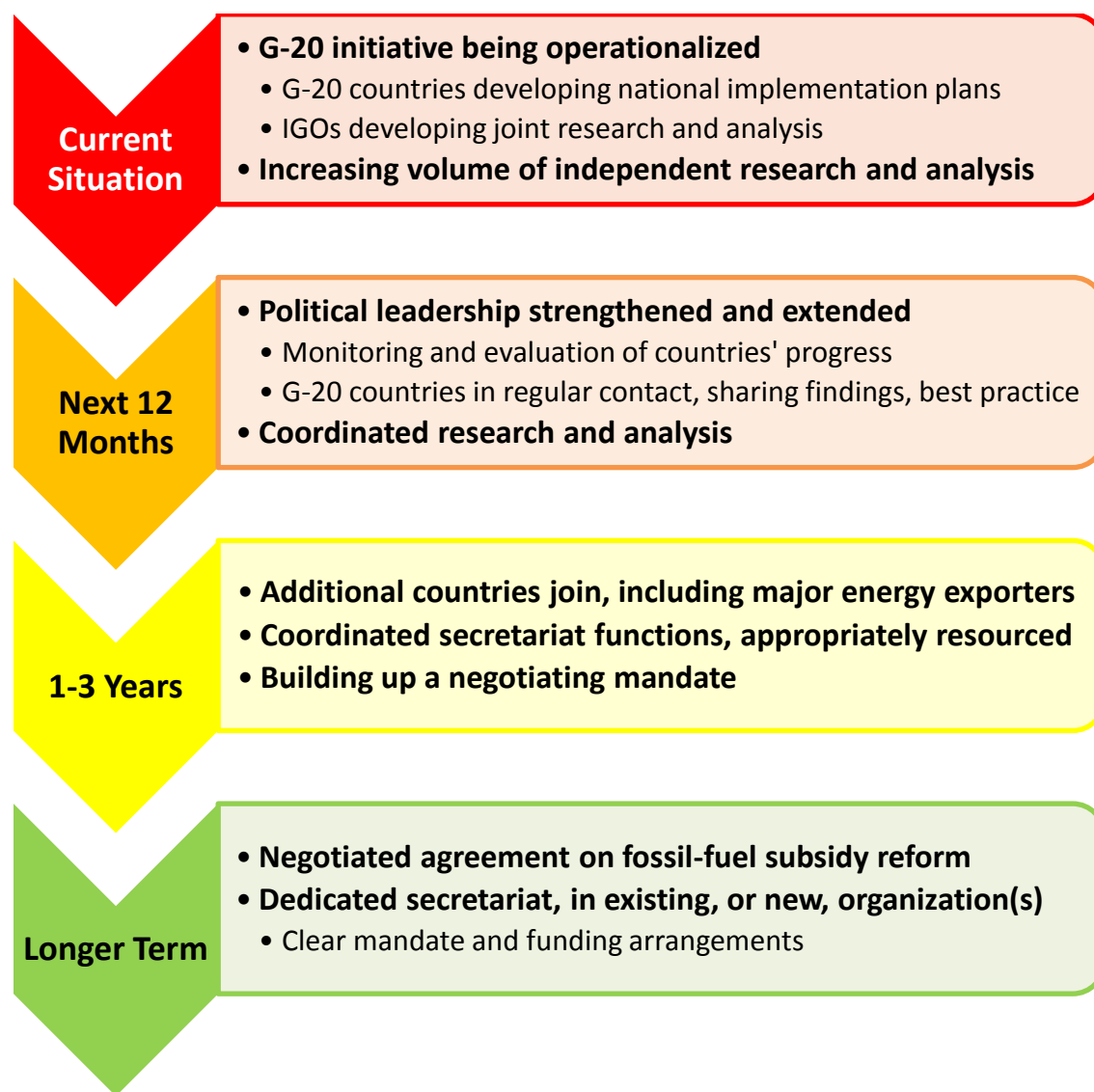
reform, or supporting it, are a recommended course of action. For developing countries, nationally appropriate mitigation actions (NAMAs) are likely to be part of their commitments to a post-2012 climate change deal. Fossil-fuel subsidy reform would fit well into such policy commitments, which could be supported by developed countries technically or financially. Both options would be dependent on progress on the post-2012 international architecture in general. The interest in and efforts of a set of countries to champion the issue of fossil-fuel subsidy reform is a prerequisite: such reform is only a theoretical option at present, and enshrining mechanisms within the UNFCCC will require a concerted effort of potentially long duration.

Many other international organizations are active in the field of energy subsidies. The International Energy Agency (IEA) and the Organisation for Economic Co-operation and Development (OECD) have strong research capacities to identify, measure and analyze the impacts of fossil-fuel subsidies. The World Bank and International Monetary Fund (IMF), in addition to their research capacities, have experience providing financial and technical support to assist developing countries in reforming harmful subsidies and introducing more effective poverty alleviation measures. The United Nations Environment Programme (UNEP) has established a body of policy research on the key issues, benefits and challenges of fossil-fuel subsidy reform. In addition, non-governmental organizations (NGOs) such as the Global Subsidies Initiative and Earth Track have substantive research and analysis capacity and play an important role in monitoring and raising awareness about new issues and the progress of national reform efforts.

The roles of these organizations will continue to be essential for supporting any initiatives to reform fossil-fuel subsidies, whether within the WTO, UNFCCC or otherwise. Not one of these organizations alone, however, can currently provide all the secretariat functions necessary to support an international movement to reform fossil-fuel subsidies.

The potential gains from fossil-fuel subsidy reform are high, and an increasing number of actors are now working toward attaining those gains. International cooperation has an important role to play. This report concludes that the efforts of a range of diverse institutions will be required in the short and medium term. A formally negotiated agreement is the long-term goal, but it is not considered possible to jump to it in a single step. The political leadership recently shown by the G-20 and subsequent collaboration of international organizations provide a good starting point. Taking the G-20 initiative to phase out inefficient fossil-fuel subsidies as its starting point, this report concludes with a Roadmap (see Figure 1.1) that plots the route toward a negotiated agreement, detailing the steps required during the short term (next 12 months), the medium term (1-3 years) and the longer term.

Figure 1.1 A Roadmap for international cooperation



2.0 Introduction

2.1 Overview

The Group of Twenty (G-20) countries are, at the time of writing (May 2010), preparing draft national implementation plans detailing how they will phase out fossil-fuel subsidies and the rationalization for doing so. These will be presented at their Leaders Summit in Toronto, 26-27 June 2010. So, is international cooperation already energizing fossil-fuel subsidy reform? While there are reasons for optimism and some progress has been made, we are far from seeing a mature, entrenched system with widespread support and a well-resourced secretariat providing the necessary support.

This paper provides a comprehensive overview of the search for a home, or homes, for hosting international deliberations and action on energy subsidy reform. The two most obvious contenders for such an “institutional home” are the World Trade Organization (WTO) and the United Nations Framework Convention on Climate Change (UNFCCC). The WTO’s Agreement on Subsidies and Countervailing Measures provides an internationally supported means for disciplining subsidies. Climate change is one of the key rationales for subsidy reform, and the UNFCCC enjoys almost universal membership. But neither organization has as yet made significant progress on fossil-fuel subsidy reform.

This paper considers the merits of the WTO and UNFCCC in detail, assessing their legal basis and how they could develop their abilities to reform fossil-fuel subsidies. The G-20 initiative is significant and, if the initiative can be embedded, could become very important. The paper thus explores the role the G-20 initiative could play.

One important difference between the G-20, compared with the WTO and UNFCCC, is its lack of a large, formal secretariat. At present, the G-20 is largely providing political leadership. The many required tasks to progress fossil-fuel subsidy reform—the “building blocks” that include generating data on the scale of subsidies, analyzing their impacts and developing reform strategies—would be delegated by the G-20 to other institutions. This provides one model going forward; the paper also analyzes the roles that a range of other institutions could play and how these could be coordinated.

2.2 Why do we need international cooperation?

The potential benefits of fossil-fuel subsidy reform are vast and varied. Reviewing the literature, much of which has been carried out by the International Energy Agency (IEA), the Organisation for Economic Co-operation and Development (OECD) and other International Governmental Organizations (IGOs), Ellis (2010) notes that the financial costs of subsidies to energy consumers

alone is on the order of US\$400 billion per year. The Global Subsidies Initiative (2009) estimates that producer subsidies may add at least another \$100 billion per year to this total.

A recent study by the OECD found that removing consumption subsidies to energy in the 20 largest developing countries over the next decade would reduce global greenhouse gas emissions by at least 10 per cent in 2050 (Burniaux et al., 2009). Subsidy reform would also contribute to improved local air pollution, improved security of energy supply and a whole host of important government aims. The Intergovernmental Panel on Climate Change, in their Fourth Assessment Report, Working Group III (Metz et al., 2007), identifies the reform of fossil-fuel subsidies, and energy sector reform more generally, as critical to sustainable energy development.

Subsidy reform must ultimately be implemented at the domestic level, necessarily taking account of political imperatives including the need to ensure that the poorest sectors of society are compensated for losses to their welfare.¹ But reform of fossil-fuel subsidies requires a strategic vision, careful planning and deployment of scarce research and political resources, as well as a long-term commitment and political will. This can best be achieved by a concerted effort of governments and the international community working together. An international agreement could provide the basis for establishing the necessary data collection, reporting and monitoring framework for fossil-fuel subsidies. It would also serve to bind the sometimes-fragile political will of governments into reduction commitments, while at the same time addressing international competitiveness concerns. In addition, it would promote efficient use and sharing of resources and, by raising the profile of the issue, encourage the participation of NGOs and other members of civil society.

2.3 A Roadmap for international cooperation

So how do we get from the current situation to one in which countries are actively identifying, reviewing and reforming their fossil-fuel subsidies? And which institutions will be needed as we move through this process? The paper identifies three chronological stages—the next 12 months, 1 to 3 years and the longer term—and, for each stage, outlines a Roadmap specifying which of the many potential institutions could play the key roles. The roles of these institutions are likely to change and develop over time: moving in one simple step from the current situation to one in which a single institution governs and supports fossil-fuel subsidy reform is not considered likely.

The Roadmap is based on meeting the objectives of an international agreement to reform subsidies to fossil fuels, namely to:

¹ For a full discussion of the political economy of energy subsidy reform, see Victor (2009).

- a. Recognize the need for reform of perverse fossil-fuel subsidies;
- b. Improve transparency and reporting of fossil-fuel subsidies;
- c. Reduce and eliminate subsidies for fossil fuels;
- d. Establish mechanisms for monitoring and ensuring compliance with commitments to reduce fossil-fuel subsidies;
- e. Promote sharing of best practice and cooperation on the reform of subsidies; and
- f. Offer capacity building and technical assistance to developing countries.

2.4 Structure of this paper

With these objectives in mind, this paper explores three channels through which an international agreement on fossil-fuel subsidies could be progressed. Section 3 explores avenues through the World Trade Organization, which offers a flexible negotiating forum with extensive technical assistance, established subsidy disciplines and reporting mechanisms, along with an effective dispute settlement body, but which is limited in its trade-focused mandate and lacks the political appetite to expand negotiations beyond what is already on the agenda for the Doha Round. Section 4 looks at the United Nations Framework Convention on Climate Change. The UNFCCC has many attributes, and fossil-fuel subsidy reform is explicitly mentioned within its text and that of its Kyoto Protocol. Yet serious efforts to include subsidy reform have not been undertaken and future agreement, especially if this were to be legally binding, would require a major effort. Section 5 considers a less formal, coordinated response by the international community, led by the G-20 political commitments to phase out subsidies to fossil fuels, as announced in Pittsburgh in September 2009.

The Roadmap is detailed in Section 6 of the paper and is based on conclusions from earlier analysis.

3.0 World Trade Organization

3.1 Historical background

There is general agreement among analysts that despite the longstanding attention given to subsidies in general within the multilateral trading system, energy subsidies—in particular, fossil-fuel subsidies—have received scant attention. The impression from the literature is that the WTO has had a history of non-involvement in energy trade issues, and fossil-fuel subsidies specifically (UNCTAD, 2000). While this impression is largely correct, it might be misleading, especially when one is considering opportunities for reform going forward. There is a thin but important history to the issue that needs to be taken into account.

Energy subsidies issues have been the subject of one form of discussion or another in the multilateral trading system from as early as the 1982 General Agreement on Tariffs and Trade (GATT) Ministerial Conference. At this Ministerial Conference, there were discussions on issues around dual pricing in the energy sector—that is, providing domestic industries with energy at a lower price than the world market (Bigdeli, 2008). Since then, we can see three other periods where energy subsidies have been the subject of discussions or negotiations in the WTO, and in which dual pricing has continued to feature highly.

First, during the Uruguay Round a number of countries, particularly the United States and the European Communities (EC), raised concerns about export restrictions by energy-exporting countries that have the effect of providing domestic industries with lower-priced energy. During the Round, Australia also led efforts to review and remove coal subsidies (Steenblik, 1998). Energy was not addressed more comprehensively during the Uruguay Round because liberalization of the sector was a lower priority than agriculture and many of the major energy exporters such as Iran, Russia, Saudi Arabia and the countries of central Asia were not WTO members (Lamy, 2007a).

Second, since the coming into being of the WTO, fossil-fuel subsidies have been a point of negotiation in the accession negotiations involving energy-exporting countries. Notable examples are the accession negotiations involving Russia and Saudi Arabia.

Finally, in the current Doha Development Round negotiations, energy subsidies have been raised in the Rules negotiations, again by the EC and the United States. There have also been some discussions on subsidies related to biofuels in the agriculture negotiations. Also potentially relevant are the Rules negotiations addressing subsidies to the fisheries sector, which may, if negotiations are concluded, demonstrate how subsidy disciplines can be developed to serve wider economic and development objectives while also benefiting the environment.

A key historical lesson is therefore that there have been opportunities and efforts to address at least parts of the fossil-fuel subsidies problem in the WTO, but these efforts have not been backed by sufficient political capital or follow up. Efforts such as Australia's during the Uruguay Round with respect to coal subsidies were never followed through and were abandoned in favour of other priorities such as agricultural negotiations (Steenblik, 1998). Efforts by the United States and the EC also appear to have suffered the same fate.

There is increasing awareness and acknowledgement that the multilateral trading system, and the WTO in particular, has to be part of the solution to climate change (Lamy, 2007b). Liberalizing trade in environmental technologies and services; trade in energy products, technologies and services; and intellectual property and trade rules, including addressing the trade impacts of climate change mitigation measures—all are vital pieces of the solution for addressing climate change.

Although systemic, prompt and deep action on fossil-fuel subsidies by the WTO is not seen as a priority among its membership, especially in the face of the slow progress of the Doha Round negotiations and the current financial crisis, trade-related responses to climate change are increasingly seen as part of the future WTO agenda. An agreement within the UNFCCC is seen as a possible catalyst for action at the WTO in coming years (Lamy, 2009c).

3.2 Why the WTO?

The WTO offers a negotiating forum with the necessary mechanisms for addressing the complex issue of fossil-fuel subsidies. The WTO's wide membership would enable negotiations to account for the diverse contexts in which fossil-fuel subsidies operate. It also offers the flexibility to address developing-country needs through special and differential provisions and through its technical cooperation, training and aid-for-trade programs. The WTO framework already has reporting and surveillance mechanisms under the Agreement on Subsidies and Countervailing Measures and its Trade Policy Review Mechanism. When implemented effectively, these reporting and review mechanisms could improve transparency and international scrutiny of national fossil-fuel subsidy programs. And finally, the Dispute Settlement Body is an effective mechanism for enforcing WTO law.

Multilateral energy subsidy reform would have an impact on energy prices, the structure of production, and trade and investment flows. In turn, these impacts would affect the competitiveness of goods, but mostly energy-intensive goods, in global markets (Saunders and Schneider, 2000). Some subsidies to fossil fuels can also be considered a barrier to trade and investment in alternative energy technologies such as renewable energy (World Bank, 2007). Extending beyond this limited view of fossil-fuel subsidies would require a negotiating mandate that seeks to address economically distorting *and* environmentally harmful fossil-fuel subsidies. This poses a key challenge for the

WTO, a trade-oriented forum.

3.3 Analysis of existing WTO disciplines

Subsidies, in general, have been part of trade negotiations dating back to GATT 1947, which addressed the question of subsidies in Article XVI. The Agreement first recognized subsidies can be trade-distorting and sought to place notification requirements on Parties, along with restrictions for the use of export subsidies. Nevertheless, the GATT provisions were very weak and subsidies were not addressed substantively until the Agreement on Subsidies and Countervailing Measures (SCM Agreement) was concluded in the Uruguay Round in 1994.

Now there are specific rules on subsidies in the SCM Agreement and the Agreement on Agriculture. The General Agreement on Trade in Services also contains a commitment requiring WTO members to negotiate specific disciplines on subsidies in the future. The current multilateral trade negotiations under the Doha Round are also addressing the question of subsidies in a number of areas, particularly for the fisheries and agriculture sectors.

3.3.1 Agreement on Subsidies and Countervailing Measures (SCM Agreement)

The SCM Agreement is the most comprehensive agreement addressing subsidies for goods in the WTO. It seeks to regulate members' use of subsidies and provide instruction as to how members can counter the adverse effects of subsidies.

The SCM Agreement defines a subsidy as a financial contribution by a government or public body, or any form of income or price support in the sense of Article XVI of GATT,² that confers a benefit on its recipients. For the purposes of addressing subsidies that meet this definition, the SCM Agreement classifies subsidies into two types: prohibited and actionable. The only exceptions are for agricultural subsidies, which are covered by special, additional rules set out in the Agreement on Agriculture.

Prohibited subsidies

There are two types of prohibited subsidies that are dealt with under Article 3: export subsidies (subsidies contingent upon export performance) and local content subsidies (subsidies contingent upon the use of domestic over imported goods). These two types of subsidies are prohibited because of their direct impact on trade.

² GATT Article XVI refers to support that “operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, [a member’s] territory.”

Where a WTO member has reason to believe that a prohibited subsidy is being granted or maintained, it may seek recourse under Article 4 (refer to Section 3.3.6 for a full explanation of the dispute settlement process).

Actionable subsidies

For a subsidy to be considered “actionable,” it must be specific to an enterprise, industry or region, the premise being that these subsidies are considered discriminatory and more likely to be trade-distorting; it must cause one of three types of adverse effects:

1. Injury to domestic industry caused by subsidized imports;
2. Serious prejudice, such as export displacement, in the subsidizing member or in a third country;
3. Nullification or impairment of benefits whereby improved market access, due to reduced tariffs, is undercut by a subsidy.

WTO members who consider they have suffered harm from a subsidy can seek consultations and remedy under Article 7 (again, see Section 3.3.6 for a full explanation of the dispute settlement process).

Monitoring and reporting

Articles 25 and 26 of the SCM Agreement provide for the notification of subsidies and a surveillance mechanism. Members must notify all specific subsidies to the SCM Committee, with sufficient detail to allow other members to assess the trade effects. New and full notifications are due every three years, with update notifications in intervening years. There is also provision for members to seek and respond to additional information requests.

A significant limitation of the surveillance mechanism is effective implementation. The difficulty is that the rates of reporting have not only been low but in fact have dropped from the initial levels in 1995 (Steenblik and Simón, 2006). As a result, subsidies are woefully under-reported in the WTO. Of course, the underperformance of the transparency system under the SCM Agreement is not a unique problem. Generally, compared with the dispute settlement system, WTO surveillance and transparency mechanisms are seen as fragile (Lamy, 2009a). The other major problem relates to the accuracy and consistency of the information provided by reporting members (WTO, 2006a).

The low rates of notifications, the lateness in submitting reports and the problems with the accuracy and completeness of reported data have been attributed to one main shortcoming of the

transparency framework under the SCM Agreement. This relates to the lack of sanctions for non-compliance or inaccurate and incomplete reporting (Steenblik and Simón, 2006; Bigdeli, 2008). It is argued that the lack of sanctions has encouraged convergence toward the lowest minimum standard on reporting. This situation also appears to discourage countries that might otherwise work with a higher standard from putting the necessary resources into basic data-collection efforts.

Negotiations under the Doha Development Agenda

The WTO Rules negotiations aim to clarify and improve the disciplines of the SCM Agreement. Under the Doha Round of negotiations, primary attention has been paid to negotiating new disciplines for subsidies to the fisheries sector.

The mandate to negotiate disciplines for fisheries subsidies was born out of a concern for depleting fish stocks. A group of concerned WTO members, international organizations and NGOs formed the “Friends of Fish” group to pursue a mandate to negotiate disciplines for fisheries subsidies at the Ministerial Conferences, first in Seattle, then in Doha, and again in Hong Kong. The Doha Ministerial recognized the need to “clarify and improve the WTO disciplines on fisheries subsidies” (WTO, 2001). The Friends of Fish achieved real success at the Hong Kong Ministerial, however, when all members agreed to a mandate to strengthen disciplines on fisheries subsidies, “including through the prohibition of certain forms of fisheries subsidies that contribute to overcapacity and over-fishing ... taking into account the importance of this sector to development priorities, poverty reduction, and livelihood and food-security concerns” (WTO, 2005). The negotiations on disciplines for fish subsidies are regarded as the first experience of regulating an environmentally harmful subsidy within the WTO (Bigdeli, 2008). Nevertheless, despite the likely environmental benefits of reducing subsidies that contribute to over-fishing and over-capacity, the principle objective of the negotiations remains rationalizing the economic activity and protecting the livelihoods of developing country fishermen (WTO, 2010).

In addition to the negotiations on fish subsidies, there have been some proposals to extend the existing disciplines of the SCM Agreement, namely by the United States and the EC. The United States proposed to expand the scope of prohibited subsidies as the next step in the progressive deepening of subsidy disciplines under Article 3 (WTO, 2006c). The proposal was to expand the category of prohibited subsidies to include “those instances of government intervention that have a similarly distortive impact on competitiveness and trade as do export and import substitution subsidies.” The United States suggested this could begin by developing criteria for a category of prohibited subsidies. The proposal also raised the possibility of improving transparency with a long-term view to discouraging members from using opaque forms of subsidy in favour of more transparent subsidies.

As an alternative, the EC proposed to expand the SCM Agreement by putting a focus on an individual member's ability to address the adverse impacts of subsidies (WTO, 2006d). In addition, the EC's submission proposed to amend Article 3 of the SCM Agreement to include in the list of prohibited subsidies "the provision, by virtue of government action, of goods to domestic production on terms and conditions more favourable than those generally available for such goods when destined for export."

These two proposals proved to be extremely controversial, as the EC proposal in particular was suspected of targeting the issue of dual pricing for energy products. Due to strong opposition, neither the United States proposal nor the EC proposal made any progress within the negotiations. The Chair of the WTO Rules negotiations issued text (WTO, 2008) that only extends the category of prohibited subsidies to encompass what will be agreed upon with respect to fisheries subsidies.

Relevance for addressing fossil-fuel subsidies

The SCM Agreement offers a legal framework that could, to some extent, address fossil-fuel subsidies without major structural changes. The first challenge is demonstrating that fossil-fuel subsidies are specific, in order to fall within the ambit of the SCM Agreement's reporting and other disciplines. This will largely depend on the type of subsidy and fuel in question. Some of the most visible and commonly used fossil-fuel subsidies are consumer subsidies that lower the retail price of products such as kerosene or petroleum. As these subsidies are widely available, often to the general public, commercial and industrial enterprises, it is difficult to conclude that they meet the specificity requirements. There may be reason to argue, however, that these types of subsidies are specific where they lower the price of feedstock for certain energy-intensive industries. Article 2.1(c) notes, "If, notwithstanding any appearance of non-specificity ..., there are reasons to believe the subsidy may in fact be specific, other factors may be considered. Such [as] ... the granting of disproportionately large amounts of subsidy to certain enterprises ... In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority...". The types of fossil-fuel subsidies that may be considered specific include where, for example, governments may provide cheap natural gas to their petrochemical industries through tiered pricing structures or through negotiated long-term contracts with individual manufacturers. Other subsidies for producers may meet the specificity requirements but they take many different forms and are often much less transparent and therefore difficult to identify in the first place.

The second challenge is demonstrating that fossil-fuel subsidies cause one of the three types of adverse trade effects listed in Article 5, in order to be considered actionable under the Agreement.

Discussions on dual pricing for fossil fuels have touched upon the issue. “Dual pricing policies” is another term for the consumer subsidies that set the domestic prices of fossil fuels lower than export prices and thereby confer a benefit to domestic industry. Energy-importing countries argue that dual pricing policies distort trade by lowering the cost of production and therefore enhancing the global competitiveness of goods produced in the subsidizing country for export; however, these arguments only extend to energy-intensive or downstream products such as aluminum, steel, pulp and paper, chemicals and cement, and fertilizers, where the cost of energy input is significant relative to total cost of production (Bigdeli, 2008). In response, energy-producing countries claim that cheap fossil fuels are their comparative advantage in producing energy-intensive goods.

The EC’s submission to extend the category of prohibited subsidies could be read as an attempt to include dual pricing of fossil fuels as a prohibited subsidy. It was met with strong opposition from members such as Saudi Arabia. The EC has, however, had some success in reducing the use of dual pricing policies by other countries in accession negotiations (discussed in Section 3.3.5). But in the multilateral negotiations, the debate as to whether dual pricing should be considered trade-distorting under the WTO remains unresolved.

Subsidies to fossil fuels can also be considered trade-distorting where they put alternative energies that do not receive comparable support at a competitive disadvantage (Bigdeli, 2008). Such subsidies are considered a barrier to trade and investment in alternative energy technologies such as renewable energy (World Bank, 2007; El Sobki, Wooders & Sherif, 2009).

The other key challenge in addressing fossil-fuel subsidies is to collect reliable data on current and future levels of support (Bigdeli, 2008). The reporting and surveillance framework established by the SCM Agreement could play a critical role in the efforts to reform fossil-fuel subsidies, but its implementation needs drastic improvement (Laan, 2010).

3.3.2 Agreement on Agriculture

Subsidies to the agriculture sector are accorded special treatment under the SCM Agreement, to be addressed more specifically under the Agreement on Agriculture. Disciplines for subsidies are softer under the Agreement on Agriculture. It classifies subsidies into three main types: direct payments under production limiting programs (“Blue Box” measures), which are exempt from commitments, subsidies with no or minimal distortive effect on trade (“Green Box” measures) and trade-distorting subsidies (“Amber Box” measures). Subsidies classified as trade-distorting are subject to reduction commitments.

Among other things, the Agreement permits export subsidies, subject to reduction commitments, as an exception to the SCM Agreement under Part V; it provides for remedies through the dispute settlement system; it contains notification requirements and consultation commitments with respect to subsidies under Article 18; and it contains commitments to continued reform of agricultural subsidies under Article 20. The Agreement also contains a “peace clause” that protects members using subsidies that comply with the Agreement on Agriculture from being challenged under other agreements such as the SCM Agreement (Article 13). One objective of the clause was to encourage full disclosure of agricultural subsidies by members. This clause has now expired, although when it was active, it further restricted the utility of the Agreement in tackling subsidies.

Relevance for addressing fossil-fuel subsidies

Subsidies for ethanol-based biofuels and the feedstock of biodiesel are covered by the Agreement on Agriculture. Fossil fuels are classified as industrial goods, however, and therefore fossil-fuel subsidies are covered by the SCM Agreement.

The Agreement on Agriculture is not a useful model for considering reform of fossil-fuel subsidies, because it establishes softer disciplines for agricultural subsidies than the SCM Agreement. It should also be noted that experience from the Doha Round of negotiations demonstrates the ongoing difficulties with negotiating gradual reduction commitments.

3.3.3 General Agreement on Trade in Services (GATS)

The General Agreement on Trade in Services, while explicitly recognizing that subsidies may have a distortive effect on trade in services, goes only as far as binding the members to enter into future negotiations to develop disciplines to address the trade-distortive effects of subsidies to services under Article XV. In addition, the GATS provides a means for members who consider themselves adversely affected by another member’s subsidies to request consultations; however, the responding member is only obligated to give “sympathetic consideration” to such requests (Article XV: 2). So far, very little information has been shared (WTO, 2006b).

The WTO’s general principle of Most Favoured Nation (MFN), under which a member cannot normally discriminate between trading partners, and members’ specific commitments to National Treatment (NT), whereby a member cannot discriminate between its own and foreign services, nationals or investment, also provide some limited scope for addressing subsidies. Subsidies that may be inconsistent with a member’s commitments on national treatment, however, will need to be considered on a case-by-case basis depending on what commitments the subsidizing member has made under the GATS.

In some cases, the benefits of subsidies can be passed down the supply chain and so the division between services and goods is not clear cut. If the benefit of a subsidy in the services sector passes through to the goods sector, then action can be taken under the SCM Agreement (Brazil–Aircraft dispute; WTO, 1999).

Relevance for addressing fossil-fuel subsidies

It is not yet clear from the agreements or negotiations whether electricity should be classified as a service or a good. If electricity is classified as an energy service and a member has made commitments to liberalize trade in energy services, and if the electricity in question is generated using cheap fossil fuels, then subsidized electricity may fall within the ambit of the GATS.

More generally, subsidized energy services for the fossil-fuel sector could be included; however, provisions to address subsidies to energy services (and possibly electricity) are limited to the voluntary consultation mechanism until further disciplines are negotiated.

3.3.4 Negotiations on environmental goods and services

For the Doha Development Agenda, Ministers issued a mandate to negotiate, for the first time, on matters related to enhancing the mutual supportiveness of trade and environment. The negotiating mandate covers three strands (WTO, 2001, Paragraph 31 of the Doha Ministerial Declaration):

- i. The relationship between existing WTO Rules and the specific trade obligations set out in multilateral environment agreements (MEAs);
- ii. Procedures for regular information exchanges between MEA secretariats and WTO committees;
- iii. Reduction or elimination of tariff and non-tariff barriers to environmental goods and services.

The negotiations on environmental goods and services have been split into two separate negotiating committees. The environmental services negotiations have merged with the GATS negotiations and the remainder of the mandate is negotiated within the Committee on Trade and Environment Special Session (CTESS).

To date, the negotiations within the CTESS have been preoccupied with modalities for reducing or eliminating tariffs on environmental goods under paragraph 31(iii). The negotiations have been stymied by an inability to agree on how to define environmental goods (possible approaches include

by end-use characteristics, by method of production and processing, by technology type and by dint of inclusion in certain “green” project types), and over the issue of goods with dual use. As such, non-tariff barriers to environmental goods have barely been touched upon.

Negotiations on trade and the environment under the CTESS are seemingly at a deadlock until progress and concessions are made within other negotiating areas of the Doha Development Agenda.

Relevance for addressing fossil-fuel subsidies

Subsidies to fossil fuels can be significant barriers to trade and investment in clean energy technologies (World Bank, 2007; El Sobki, Wooders & Sherif, 2009). Given that the mandate under paragraph 31(iii) requires negotiators to consider non-tariff barriers to environmental goods, it is conceivable that some fossil-fuel subsidies posing such barriers could be raised under the CTESS negotiations. This could involve members voluntarily offering to reduce their subsidies as part of their commitment to progress the liberalization of trade in environmental goods, or it could form part of a request-offer approach. In order to progress this, however, more information and analysis would need to be undertaken on which types of subsidies to fossil fuels are posing non-tariff barriers to environmental goods.

At first glance, it appears that extending discussions under paragraph 31(i) could serve to improve the landscape for addressing subsidies to fossil fuels by strengthening the relationship between WTO Rules and trade-related obligations under the UNFCCC, namely, language in the Kyoto Protocol whereby Annex 1 countries should “further elaborate policies and measures in accordance with its national circumstances, such as: ... (v) Progressive reduction or phasing out of market imperfections, fiscal incentives, tax and duty exemptions and subsidies in all greenhouse gas emitting sectors that run counter to the objective of the Convention and application of market instruments” (United Nations Framework Convention on Climate Change, Kyoto Protocol, 1998). Paragraph 31(i) is narrow, however, and relates only to specific trade obligations. The provision within the Kyoto Protocol merely requires Parties to give priority to the measures listed; they are not obliged to implement the measures. The provision requiring members to give priority to these measures would not be considered specific trade obligations for the purposes of addressing the relationship under paragraph 31(i).

Support for addressing fossil-fuel subsidy reform could be rendered through a joint effort of the WTO and UNFCCC under paragraph 31(ii). Activities under paragraph 31(ii) could extend to joint technical assistance and capacity-building activities (UNEP/WTO, 2009). See Section 4 for a full discussion of the UNFCCC’s current and potential provisions.

3.3.5 Accession negotiations

The process of accession requires the country seeking WTO membership to obtain consent from each of the members who have opted to be on the Working Party for Accession. In practice, this often requires negotiating bilateral agreements with those members. The EC has raised the issue of dual pricing for fossil fuels in accession negotiations of energy-exporting countries such as Russia, Saudi Arabia and the Ukraine.

In Russia's accession negotiations, the EC asked Russia to abolish its low domestic gas and electricity prices. The EC claimed that Russia's low domestic prices (one-quarter of the export price) provided an unfair advantage to Russia's domestic industry over foreign competitors. Russia initially resisted the request to abolish dual pricing, claiming it exceeded the parameters of the WTO; however, the EC persisted and was successful in getting Russia to agree to incrementally raise domestic gas prices for industrial users (ICTSD, 2004a; ICTSD, 2004b).

The EC pursued similar objectives during accession negotiations with Saudi Arabia; however, in these negotiations Saudi Arabia was more successful in standing its ground. The two members agreed that Saudi Arabia's dual pricing for natural gas could remain intact, providing that domestic prices were set on a commercial basis that would ensure the full recovery of production costs and a reasonable profit (Bigdeli, 2008).

Relevance for addressing fossil-fuel subsidies

The EC has demonstrated that it is possible to address issues related to fossil-fuel subsidies in the accession negotiations on a bilateral basis. But attempting to address subsidy reform through accession negotiations is inherently unfair, as it targets non-members only, with no mechanism for ensuring reciprocity by members. Such a system would miss significant fossil-fuel subsidies granted by WTO members. Nor are the bilateral accession negotiations capable of addressing fossil-fuel subsidies in a consistent manner, as is illustrated by the two different outcomes of Russia's and Saudi Arabia's negotiations.

3.3.6 Dispute settlement

As noted in Section 3.3.1, members have recourse to a dispute settlement process under the SCM Agreement where they have reason to believe a prohibited subsidy is being granted by another member (Part II) or where the complaining member considers it is suffering adverse effects from a subsidy deemed to be actionable (Part III). The process starts with requests for consultations to find mutually agreeable solutions, which could include compensation. If a mutually agreeable solution is

not reached (within 60 days for an alleged actionable subsidy, or within 30 days for an alleged prohibited subsidy), then a Party can refer the matter to the Dispute Settlement Body.

If the Dispute Settlement Body, through a decision of the Panel or, if appealed, of the Appellate Body, finds that a subsidy is causing adverse effects, then the member with the subsidy must take appropriate steps to address the adverse effects or remove the subsidy within six months, or where it finds that a prohibited subsidy exists, it must be removed “without delay” within the time frame set by the Dispute Settlement Body.

If the member with the subsidy fails to take appropriate action, the complaining member may take countermeasures, such as imposing an additional duty on the subsidized imports (known as a countervailing duty).

Through the Dispute Settlement Body, a considerable volume of WTO law has developed.³ It is not within the scope of this paper to attempt to summarize the case law, but rather to show how the dispute settlement mechanism can help address fossil-fuel subsidies within the WTO.

Relevance for addressing fossil-fuel subsidies

As with subsidies in any sector, if a member considers that a fossil-fuel subsidy meets the definition and specificity requirements and is either prohibited, or causing adverse effects, in accordance with the relevant provisions of the SCM Agreement, then that member has recourse through the dispute settlement process. In addition to the challenge of demonstrating that a fossil-fuel subsidy meets the SCM Agreement specificity requirements as outlined earlier in this paper, however, there are a number of other limitations on addressing fossil-fuel subsidies through dispute settlement.

A significant obstacle to bringing a complaint before the Dispute Settlement Body, or even in requesting consultations, is the burden of proof that is placed on the complaining member to demonstrate the existence and nature of the subsidy (Articles 4.2 and 7.1). In addition, for alleged actionable subsidies, the complaining member must also show the adverse effects caused by that subsidy (Article 7.1). Given the low levels of compliance with notification obligations under the SCM Agreement, the relevant information is less likely to be provided by the subsidizing member or readily available to other members—although once a dispute has been initiated, Annex V outlines procedures for developing information concerning serious prejudice that may help improve the transparency of a member’s subsidy programs, albeit on a very limited basis.

³ For an overview of articles and text within the SCM Agreement that have been the subject of WTO case law, see http://www.wto.org/english/res_e/booksp_e/analytic_index_e/subsidies_e.htm.

If the fossil-fuel subsidy in question is not a direct transfer that is visible on the public accounts, it can be very difficult to identify and estimate the value of the subsidy provided by another member, let alone assess the full extent of the trade impacts. The types of subsidies often provided to fossil-fuel producers can in fact be characterized by the lack of transparency and opaqueness of the indirect mechanisms most often used to confer benefits to producers (Victor, 2009).

3.4 The political landscape for reform

There are a number of opportunities that offer entry points for a potential agreement on fossil-fuel subsidy reform within the WTO framework. Being a member-driven forum, the primary challenge of addressing fossil-fuel subsidies in the WTO is finding the political appetite to embark on the process.

With diminishing optimism for a multilaterally negotiated agreement on climate change, more attention is being focused on efforts to address climate change at the domestic level, including increased recognition of the benefits of fossil-fuel subsidy reform. The Obama administration and the Group of Twenty (G-20) major industrialized and emerging nations have singled out fossil-fuel subsidies as a priority area for reform (G-20 Leaders, 2009; Obama, 2009). Even before the heightening of concerns about climate change, governments have, over time, been increasingly questioning the validity of certain types of fossil-fuel subsidies based on environmental, social, economic and financial considerations (Bigdeli, 2008; UNEP, 2008).

Climate change is now openly acknowledged as one of the key issues that the international community, including the multilateral trading system, has to address (Lamy, 2009c); albeit for the WTO the Doha Round must take first priority (Lamy, 2009a). Although the time scale may be long, there are important developments within the WTO that may provide precedents for future reform of fossil-fuel subsidies. The fisheries subsidies reform efforts suggest there is a realistic possibility of achieving a shift in thinking at the WTO with concerted effort to build better information, public understanding and sensitization among governments on subsidy issues.

3.4.1 Better implementation of the SCM Agreement

Better information and transparency is the first step toward understanding fossil-fuel subsidies and their impacts on trade, the economy, the environment and social welfare. It is a prerequisite for thinking through the types of incentives and trade-offs that would be required to negotiate comprehensive reform in the longer term. Improved reporting and transparency would also enhance members' opportunities to address the adverse effects of other members' subsidies under the disciplines of the SCM Agreement.

A number of proposals have already been floated suggesting how to improve the reporting of subsidies under the SCM Agreement. Two particular proposals, which are complementary, offer a way forward because they address both the clarity and completeness question and provide a basis for moving toward a sanctions regime. The first is the proposal by Steenblik and Simón (2006) for a new template for notifying subsidies to the WTO. This proposal would be organized around a summary table that standardizes how information should be reported and a notification annex as the framework for providing details of subsidy programs. The second is Bigdeli's proposal calling for the establishment of a subsidy-watch committee as a subsidiary body to the Committee on Subsidies and Countervailing Measures (CSCM) and that would be different from the current Permanent Group of Experts. This committee would have the primary function of examining whether each member's energy subsidy notification sufficiently represents the level of support in this sector (Bigdeli, 2008).

The fundamental obstacle underlying the low and inconsistent reporting rate, however, remains the lack of political will to improve.

3.4.2 Progressing negotiations under the Doha Round

Improvements to the SCM Agreement

Within the WTO Rules negotiations there have been proposals to improve disciplines under the SCM Agreement for subsidies in general. The United States proposed to expand the categories of prohibited subsidies and the EC proposed to improve members' abilities to address the adverse impacts of subsidies.

These proposals were dropped in the negotiations, however, due to strong opposition. The current draft of the Chair's text (December, 2008) does not include reference to either proposal. In theory, any member could re-introduce these proposals or make new proposals (such as introducing incentivizing measures for complying with reporting obligations).

The WTO is aiming to conclude negotiations by the end of 2010, and that timeline was reaffirmed by G-20 Leaders in Pittsburgh (G-20 Leaders, 2009). While this timeline may or may not be realistic, it is still clear that the talks are at an advanced stage, with nine years of history behind them. As such, negotiators would be extremely reluctant to add new topics to the negotiating agenda, preferring instead to focus on resolving the remaining areas of contention.

Trade and environment negotiations

Section 3.3.4 outlines how, if subsidies for fossil fuels are considered non-tariff barriers to alternative energy technologies, they could, in theory, be partly addressed by the trade and environment negotiations under the Doha Round (specifically, the environmental goods and services negotiations). The political feasibility of this option is basically non-existent, however. As noted above, the negotiations to date have been bogged down in definitional issues and have struggled to agree upon modalities for reducing tariffs on environmental goods. It is extremely unlikely the negotiations will manage to extend to addressing non-tariff barriers during the Doha Round, although the mandate to address non-tariff barriers is likely to become part of the implementation agenda for the Doha Round results.

Pascal Lamy has repeatedly stated that direction on climate change policies must come from a multilateral agreement embracing the major emitters and that trade-related aspects of climate change and energy belong not in the Doha Round, but in future rounds of multilateral trade negotiations (Lamy, 2009a; Lamy, 2009c).

3.4.3 Looking beyond the Doha Round

With mounting efforts to combat climate change, it is likely that, moving beyond the Doha Round, the next round of multilateral trade negotiations will include a focus on energy, which would provide the necessary context for addressing subsidies to fossil fuels in a comprehensive agreement.

Negotiating stricter disciplines for subsidies to fossil fuels could follow either of two routes:

1. Use the SCM Agreement in its current form but strengthen the disciplines and introduce new incentives for compliance.
2. Negotiate a sectoral Agreement on Energy that sets new disciplines specifically for reducing and ultimately eliminating subsidies to fossil fuels.

The precedent for negotiating a sectoral approach, for subsidies in particular, has been set by both the agriculture and fisheries negotiations, albeit with unique particularities. The approach taken under the Agreement on Agriculture provides special treatment for agricultural subsidies. This does not provide a good model for fossil-fuel subsidies, because the Agreement on Agriculture actually softens the disciplines compared with the disciplines under the SCM Agreement, and negotiating gradual reductions can be difficult and prolonged, as witnessed in the Doha Round of negotiations. Any proposal for fossil-fuel subsidies would want to strengthen the disciplines (“ASCM plus”), not soften them.

The negotiating mandate for disciplines for fisheries subsidies provides a basis for taking a holistic approach to the harmful effects of subsidies, as the negotiations are driven primarily by environmental, economic and development concerns rather than traditional trade-oriented objectives. Bigdeli (2008) offers an incisive analysis of the similarities and differences between the fisheries subsidies initiative and any initiative on fossil-fuel subsidies. With respect to similarities, the main unifying point relates to the fact that in both the case of fisheries subsidies and fossil-fuel subsidies the environmental aspects appear to be more important than their trade-distortive effects; however, going beyond the trade distortion argument requires more complex bargaining and trade-offs. The main difference relates to the degrees of complexity and political sensitivities associated with the two sectors. Regulation of fossil-fuel subsidies poses significantly more complex challenges than in the case of fisheries subsidies. The differences between those countries that may focus on trade distortion and environmental concerns and those that mainly focus on energy as a comparative advantage involve much higher political stakes.

A sectoral agreement could take two forms—negotiated as a single undertaking through a multilateral round of negotiations, or negotiated as a plurilateral agreement on a separate track to the multilateral negotiations. Both of these options would face similar political difficulties in achieving consensus. In order to negotiate a plurilateral agreement on a separate track to the multilateral rounds, all WTO members must agree to allow a sub-group of the full membership to proceed in establishing the plurilateral process. Once this consensus is obtained, a plurilateral agreement may be easier to negotiate but would only be worthwhile if all of the key energy-producing and energy-consuming countries were on board, crossing the important political divide.

3.4.4 Preparing the way for future negotiations

Three enduring lessons can be learned from the fisheries subsidies negotiations that can be applied to future fossil-fuel subsidy reform. The first lesson is that it is possible within the WTO to expand a negotiating mandate for subsidy disciplines beyond a trade-oriented agenda.

The second lesson relates to the need for a group of first-mover countries. One of the critical success factors for achieving consensus among WTO members on the importance of addressing fish subsidies was the cooperation of a wide range of stakeholders, including some WTO members (“Friends of Fish”), both developed and developing countries, NGOs, and key international organizations such as the United Nations Environment Programme (UNEP) and the Food and Agriculture Organization (FAO).

The final key lesson is that an incremental approach combining technical work and awareness building holds a lot of promise. Pascal Lamy, in an address to a Trade, Energy and Environment conference in October 2009, noted three important steps for introducing a new topic to the WTO:

gathering facts, initiating discussion, and then negotiating the rules (Lamy, 2009b). Perhaps the recent announcement by the G-20 countries, most of which are also WTO members, committing themselves to phase out subsidies to fossil fuels, will provide the necessary kickstart to this process.

It is clear that including fossil-fuel subsidies on the WTO's agenda is not politically feasible within the short term, particularly while the Doha Round of negotiations remains open. In the longer term, however, the WTO provides a natural home for negotiating disciplines for energy subsidies. In the meantime, much needs to be done to advance the technical work and awareness raising that pave the way for future negotiations.

4.0 United Nations Framework Convention on Climate Change

Would the United Nations climate regime make a good home for an international agreement on fossil-fuel subsidy reform? Possibly yes—but most likely, no. The United Nations Framework Convention on Climate Change (UNFCCC) is a natural home for anything with a climate change focus—many countries treat this as one of the key rationales for subsidy reform—and it provides a comprehensive forum wherein 194 countries currently participate. And, as argued below, there are elements in the Convention that could be construed as giving UNFCCC a mandate to address fossil-fuel subsidies. But finding political interest in pursuing that mandate would be challenging. The climate regime has traditionally steered well clear of prescribing or harmonizing national policies even at its strongest moments, and its vitality has been sapped by having to devote attention to addressing the uncertain and divisive aftermath of the Conference of the Parties (COP) held in Copenhagen. As well, the entire direction of the international climate change regime is radically changing to one in which the UNFCCC plays an increasingly minor role, focusing on reporting and verification, with rules for counting greenhouse gas emissions and related mitigation activities likely to be developed within countries and regions. Under such a scenario, the scope for coordinating fossil-fuel subsidies then, appears even more remote. Finally, energy remains such an important part of many economies that hosting an agreement within an organization focused on climate change may not take sufficient account of all countries' policy priorities. But while the UNFCCC as an institutional home for fossil-fuel subsidy reform presents what may be insurmountable challenges, there are still international actions that might be advanced on elements of it within the climate regime.

This section concentrates on two key questions to assess the suitability of the UNFCCC to house some or all of an international agreement on fossil-fuel subsidy reform:

1. What possible legal basis is there and what possible entry points for an international agreement on subsidy reform within the UNFCCC? What alternatives are there to a dedicated formal agreement? (Section 4.1.)
2. What challenges might make it difficult to take advantage of those opportunities? (Section 4.2.)

We end by drawing a set of conclusions and recommendations in Section 4.3.

4.1 Legal basis and possible entry points

4.1.1 Purpose and scope of the UNFCCC (UNFCCC, 1992)

The ultimate objective of the UNFCCC is the “stabilisation of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system” (Article 2). The UNFCCC has established itself as the pre-eminent forum for international discussions on climate change over the past 20 years. Although this may change somewhat post-Copenhagen, if discussions on subsidy reform are driven by climate change considerations, then we could expect the UNFCCC to continue to play an important role.

The Group of Twenty (G-20) communiqué from its Leaders Summit in Pittsburgh in September 2009 (G-20 Leaders, 2009), however, included subsidy phase-out under the G-20’s Energy Security and Climate Change work program. This introduces the idea that climate change is not the only motivation for subsidy reform: energy security, local air quality improvement, improving a country’s finances and improving the competitiveness of a country’s energy companies are some of the issues countries may consider when assessing whether to reform their subsidies. The UNFCCC does include references to sustainable development: for example, its preamble includes text requiring “responses to climate change to be coordinated with social and economic development in an integrated manner” and the Clean Development Mechanism (CDM) of the Kyoto Protocol explicitly requires projects to contribute to sustainable development. But the UNFCCC is predominantly focused on climate change.

The UNFCCC focuses on a global issue—climate change—but is careful to distinguish how individual states should act with respect to this issue: states’ “participation in an effective and appropriate international response [should be in] accordance with their common but differentiated responsibilities and respective capabilities and their social and economic conditions,” recalling that they have “the sovereign right to exploit their own resources pursuant to their own environmental and developmental priorities.”

Whether the UNFCCC’s focus on global partnership would be suitable to support subsidy reform depends to some extent on whether the most important impacts of subsidy reform occur at the international or national level. Subsidy reform is often presented as having financial benefits to the country that implements it; i.e., subsidy reform is already in the economic interest of the implementing country before it considers the value of the environmental and other side benefits (Ellis, 2010). This indicates that the decision to reform subsidies has an important national dimension; indeed, energy policy more generally and energy pricing policy in particular are often extremely important elements of countries’ overall policy packages. But the international dimension—notably the impacts on climate change, but also impacts on energy markets and other

pollutants—indicates that subsidy reform is also an international issue. Such a mixture of international and national impacts is common across many of the policies addressing climate change.

4.1.2 The UNFCCC's legal framework

Understanding how the UNFCCC is set up legally is essential to understanding how subsidy reform might be included.

The Convention

The UNFCCC (“the Convention”) was adopted on 9 May 1992 and entered into force on 21 March 1994. Nearly all countries have ratified the Convention. There are currently 194 Parties, including all members of the G-20 (United Nations Framework Convention on Climate Change, 2010).

The Convention does not include specific provisions directly relating to energy subsidies. Key provisions with relevance for subsidy reform are:

CBDR. Article 3.1 of the Convention refers to “common but differentiated responsibilities” (CBDR): “Parties should protect the climate system for the present and future generations ... in accordance with their common but differentiated responsibilities and respective capabilities. Accordingly, the developed country Parties should take the lead in combating climate change” Developed and developing country Parties tend to have different interpretations of the meaning of CBDR: developing countries emphasize the responsibility of developed countries to mitigate greenhouse gas emissions, while developed countries stress the need to consider developing countries’ growing emissions and evolving capabilities. This tension forms a backdrop to much of the UNFCCC’s negotiations and is related to questions of equity and historic responsibility.

Article 4.1(b) requires all Parties (taking into account CBDR) to “formulate, implement, publish and regularly update national ... measures to mitigate climate change by addressing anthropogenic emissions by sources and removals by sinks” In line with the CBDR, developed countries have agreed to take the lead in combating climate change and have assumed more specific mitigation commitments under the Convention and the Kyoto Protocol.

Article 4.8 refers to “the impact of the implementation of response measures ... on ... (h) Countries whose economies are highly dependent on income generated from the production, processing and export, and/or on consumption of fossil fuels and associated energy-intensive products.” This provision has primarily been used by oil-exporting countries to argue that they should receive compensation if countries reduce their oil consumption through the implementation of greenhouse-gas abatement measures.

Annex I and non-Annex I countries. Annex I lists the developed countries and countries with economies in transition expected to take the lead on reducing their impacts on climate change. Under the Kyoto Protocol, Annex I countries have committed to legally binding emission reduction targets to limit their greenhouse gas emissions. The distinction between Annex I and non-Annex I countries has been an enduring split within the Convention’s history. **Articles 12.2(a)** and **12.2(b)** require the Annex I countries to give both “a detailed description of the policies and measures it has adopted to implement its commitment” and “a specific estimate of the effects that the policies and measures ... will have on anthropogenic emissions.”

The Kyoto Protocol

Article 17 of the Convention allows for “protocols” to be adopted in order to complement the details of the UNFCCC legal regime. The Kyoto Protocol, adopted on 11 December 1997, is the only protocol adopted under the UNFCCC to date, entering into force on 16 February 2005.⁴ In April 2010, the Kyoto Protocol had 189 national ratifiers plus the European Community, representing 63.7 per cent of Annex I emissions. The United States remains the only significant non-ratifier: as such, it can only participate as an observer to the proceedings (as per Article 13.2 of the Kyoto Protocol). The US non-ratification of the Kyoto Protocol has been a key consideration shaping recent negotiations under the UNFCCC regarding long-term international cooperation on climate change (see the section on the Bali Action Plan below).

The Kyoto Protocol is important in that it gives specificity to the general commitments set out in the UNFCCC. The key feature of the Protocol is that it establishes legally binding, quantified emission reduction targets for Annex I countries during the first commitment period between 2008 and 2012. Accordingly, Annex I countries are required to reduce their greenhouse gas emissions by an average of 5.2 per cent from 1990 levels. The Protocol does not, however, specify what policies and measures must be adopted to achieve those reductions.

⁴ This date is 90 days after the date by which 55 countries representing at least 55 per cent of Annex I carbon dioxide emissions in 1990 had ratified it.

In order to ensure its cost-effective implementation, the Protocol also introduces three so-called flexibility mechanisms allowing Annex I countries to implement part of their emission targets by purchasing carbon credits from abroad: an emission trading system among Annex I Parties; a mechanism whereby Annex I Parties can claim credit for greenhouse gas-reducing investments in other Annex I Parties (Joint Implementation); and a mechanism whereby Annex I Parties can claim credit for greenhouse gas-reducing investments in non-Annex I Parties (the Clean Development Mechanism, or CDM).

Article 2.1(a) of the Kyoto Protocol lists a number of policies and measures (PAMs) that Annex I countries might take to reduce their greenhouse gas emissions and meet their targets. This is an illustrative list only, however: the Protocol ultimately leaves it up to each Annex I country to decide the means through which it implements its emission reduction target and in which economic sectors. The list includes explicit reference to subsidies: “Each Party included in Annex I ... shall ... implement and/or further elaborate policies and measures in accordance with its national circumstances, such as ... (v) Progressive reduction or phasing out of market imperfections, fiscal incentives, tax and duty exemptions and subsidies in all greenhouse-gas emitting sectors that run counter to the objective of the Convention and application of market instruments.”

Also pertinent to the discussion of subsidies is **Article 3.14**. It provides that “[e]ach Party included in Annex I shall strive to implement ... commitments ... in such a way as to minimize adverse social, environmental and economic impacts on developing country Parties, particularly those identified in Article 4, paragraphs 8 and 9, of the Convention.” (Article 4.8 includes the major developing country net exporters of oil; Article 4.9 the Least Developed Countries (LDCs).) Article 3.14 also advises on potential mechanisms for redress of economic loss: “Among the issues to be considered shall be the establishment of funding, insurance and transfer of technology.” The CMP (the “COP” of the Kyoto Protocol—see section below) in December 2005 made a decision to further clarify “Matters relating to Article 3, paragraph 14, of the Kyoto Protocol.”⁵

Paragraph 8 of the Decision requires Convention Annex II countries (developed countries not including transition economies), and those additional Annex I countries in a position to do so, to prioritize certain actions. Paragraph 8(a) lists, “The progressive reduction or phasing out of market imperfections, fiscal incentives, tax and duty exemptions and subsidies in all greenhouse-gas emitting sectors” Article 3.14 and associated Decision 31/CMP.1 are, in effect, asking that developed countries reduce the market-distorting measures that lead to excess greenhouse gas emissions. Subsidies are mentioned by name, “in all greenhouse-gas emitting sectors.” The requirement to do so while “taking into account the need for energy price reforms to reflect market prices and externalities, in pursuit of the objective of the Convention,” can be interpreted to intend that

⁵ Decision 31/CMP.1, “Matters relating to Article 3, paragraph 14, of the Kyoto Protocol,” <http://unfccc.int/resource/docs/2005/cmp1/eng/08a04.pdf#page=8>.

developed countries should prioritize those actions that would lead to the highest levels of emissions, for example, support for the construction of coal-fired power stations, coal having a higher carbon content than other fossil fuels used to generate electricity.

In summary, the Kyoto Protocol, while it goes further than the Convention in specifying the final effect of national policies and measures, notably does not go further in specifying the character of those policies and measures. In both the Kyoto Protocol and Convention processes over the years, most Parties staunchly resisted any efforts to intrude on an area that they saw as a matter of national sovereignty. Ultimately, the strongest agreement possible has been the illustrative list of policies and measures spelled out in Article 2.1(a)—the list of which, as noted above, included the reduction or phasing out of fossil-fuel subsidies.

The COP and the CMP

The Conference of the Parties (COP) is the “supreme body,” the highest decision-making authority under the Convention. It meets once a year, unless the Parties decide otherwise. Similarly, the CMP (Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol) serves as the “supreme body” of the Kyoto Protocol. It meets at the same time as the COP. Successive decisions made by the COP make up a detailed set of rules for practical and effective implementation of the Convention. Box 4.1 indicates the types of decisions the COP can make, which range from binding actions to non-binding recommendations.

The UNFCCC’s Secretariat and its two Subsidiary Bodies—the Subsidiary Body for Scientific and Technological Advice (SBSTA) and the Subsidiary Body for Implementation (SBI)—work as directed by the COP and CMP; they do not initiate independent research.

Box 4.1 Conference of the Parties (COP): Decision types

Decision: A formal agreement that (unlike a resolution) leads to binding actions. It becomes part of the agreed body of decisions that direct the work of the COP.

Declaration: A non-binding political statement made by Ministers attending a major meeting (e.g., the Geneva Ministerial Declaration of COP 2).

Resolution: A directive that guides the work of the COP—opinions rather than permanent legal acts. Unlike decisions, resolutions do not generally become part of the formal body of legislation enacted by the COP.

Recommendation: A formal act of the COP that is weaker than a decision or a resolution and is not binding on Parties to the Convention.

The Bali Action Plan

In light of climate science, including the Fourth Assessment Report by the Intergovernmental Panel on Climate Change, it is obvious that the modest emission reductions required by the Kyoto Protocol are not adequate to achieve the UNFCCC's ultimate objective of preventing dangerous anthropogenic climate change. Since the entry into force of the Kyoto Protocol in 2005, countries have thus engaged in negotiations to enhance international climate change cooperation. An important step in the process was the Bali Action Plan (BAP), agreed upon at COP 13 in December 2007.⁶ It set a two-year negotiating time frame, aiming for an agreement at Copenhagen (December 2009) on "long-term, cooperative action, now, up to and beyond 2012." The BAP seeks to enhance action on the key building blocks of international climate change cooperation, namely mitigation, adaptation, technology and capacity building, as well as the provision of financial resources and investment. The BAP also requested Parties to specify a shared vision on long-term cooperative action, including a global long-term goal for emission reductions.

The BAP also introduced the concept of nationally appropriate mitigation actions (NAMAs) (Paragraph 1(b)(ii) of the BAP). These "nationally appropriate mitigation actions" would be made by "developing country Parties in the context of sustainable development, supported and enabled by technology, financing and capacity-building, in a measurable, reportable and verifiable manner." NAMAs are seen by many as a sort of intermediate step toward hard commitments for developing country Parties, but they have yet to be fleshed out in any level of detail. Would support be financial, and if so, governed by what body? Would the actions themselves be supported, or just the preparatory measures? Would emission reductions be creditable in a CDM-like fashion? Of most interest to the question of fossil-fuel subsidy reform is simply that the actions in question could conceivably be any sort of regulatory or policy measures that achieved greenhouse gas emission reductions.

Procedurally, negotiations on long-term international climate cooperation are proceeding along two separate tracks. This negotiating structure relates to the desire by developing countries to retain the Kyoto Protocol in the post-2012 period and maintain "a firewall" between mitigation actions by developed and developing countries. Many developed countries, however, stress that effectively combating climate change requires broader participation in mitigation efforts, involving both the United States and major emitting non-Annex I countries. Two negotiating bodies are therefore dealing with long-term issues under the UNFCCC, namely:

⁶ Decision 1/CP.13 of the Report on the Conference of the Parties on its thirteenth session, held in Bali from 3 to 15 December 2007, "Addendum Part Two: Action taken by the Conference of the Parties at its thirteenth session." Decisions adopted by the Conference of the Parties. FCCC/CP/2007/6/Add.1. 14 March 2008.

- The Ad hoc Working Group on further commitments for Annex I Parties under the Kyoto Protocol (AWG-KP), which was established by CMP 1 in Montreal in 2005 to consider further commitments of industrialized countries under the Kyoto Protocol for the period beyond 2012. As such, the AWG-KP's mandate is fairly limited. The AWG-KP was set to complete its work in Copenhagen in 2009, but as it was unable to do so, the COP 5 decided to increase its timeline until CMP 6 at the end of 2010.⁷
- The Ad hoc Working Group on Long-term Cooperative Action under the Convention (AWG-LCA), which was established through the Bali Action Plan in 2007 with a broad substantive mandate covering the key building blocks identified above. The AWG-LCA was set to conclude its work at COP 15 in Copenhagen in 2009; however, there was no conclusive outcome from Copenhagen, and the AWG-LCA also was instructed by the COP to continue its work until the end of 2010.⁸

At various times during the period 2007–2009, proposals were made to advance one or both work-streams, to combine them, and to drop one or both. How these discussions will finally play out is a key input into the post-2012 legal framework within which subsidy reform could sit. A very important dynamic relates to the fact that the United States—being the world's second largest emitter of greenhouse gases—has not ratified the Kyoto Protocol. This means that the United States is only an observer to the AWG-KP negotiations and is not willing to participate in negotiations on Annex I country commitments under the Kyoto Protocol for the post-2012 period.

The Copenhagen Accord

Negotiations by the AWG-KP and AWG-LCA were set to conclude at the Copenhagen Climate Change Conference in Denmark at the end of 2009. The Conference received unprecedented media attention and was attended by more than 110 heads of state and government. During the final days, a “Friends of the Chair” group with several of the world's leaders reached agreement on a document called the Copenhagen Accord. When presented to the COP, however, a small number of countries opposed its adoption, criticizing both the Accord's weak substance and the non-inclusive and non-transparent manner through which it had been negotiated. In the end, the COP could only agree to “take note” of the Copenhagen Accord. Parties therefore established an unprecedented procedure whereby countries could register their support for the Accord with the UNFCCC Secretariat and pledge mitigation actions.

⁷ See draft decision -/CP.15, “Outcome of the work of the Ad Hoc Working Group on Long-term Cooperative Action under the Convention,” http://unfccc.int/files/meetings/cop_15/application/pdf/cop15_lca_auv.pdf.

⁸ See draft decision -/CMP.5, “Outcome of the work of the Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol,” http://unfccc.int/files/meetings/cop_15/application/pdf/cmp5_awg_auv.pdf.

⁹ Copenhagen Accord, Decision -/CP.15, http://unfccc.int/files/meetings/cop_15/application/pdf/cop15_cph_auv.pdf.

As of April 2010, 112 countries had indicated their support for the Copenhagen Accord, including Brazil, China, the European Union, India, Japan, South Africa and the United States. Forty-one Annex I countries and 35 non-Annex I countries have also provided information on their emission reduction targets and other mitigation actions, as agreed upon under the Accord. Because the Accord was not formally adopted, it does not have the legally binding status of a COP Decision or UNFCCC Protocol. It is therefore best seen as a political agreement. How it might develop and to what extent it will affect further negotiations under the UNFCCC depends on discussions that are scheduled to continue in June 2010 based on a new Chair's draft negotiating text; immediately after the Copenhagen Conference there was a vision that the Accord might become legally binding and include "real, measurable and verifiable" commitments.¹⁰

In terms of climate change mitigation, the Copenhagen Accord retains the split between Annex I and non-Annex I countries. It requires Annex I Parties to implement quantified economy-wide emission targets for 2020. Non-Annex I Parties will implement nationally appropriate mitigation actions, with those seeking international support to be "recorded in a registry along with relevant technology, finance and capacity-building support." The fact that a number of non-Annex I countries have pledged and registered mitigation actions under the Accord can be seen as one of its most important achievements.

The Accord is very general in nature. Subsidy reform, like any other specific mitigation policies and measures, are not mentioned in it. Within the lists of actions pledged by non-Annex I Parties by April 2010, there were no explicit commitments to reform fossil-fuel subsidies.¹¹

4.1.3 The current status of negotiations

Any sort of proposal for change to the legal framework that would seek to pursue fossil-fuel subsidy reductions would have to be considered in light of the capacity of the negotiators to focus on such a change, and in light of the dynamics of the current efforts to pursue the mandates discussed above.

As of this writing (May 2010), it remains unclear how the two negotiating tracks described above could be reconciled. This is problematic, since it is something of a chicken-and-egg problem: if the two tracks persist, developed countries will be unwilling to make hard commitments in the Kyoto Protocol negotiations that, in any case, do not include the United States and do not address developing country commitments. But until such commitments are made and developing countries

¹⁰ "Copenhagen United Nations Climate Change Conference ends with political agreement to cap temperature rise, reduce emissions and raise finance," Press release, http://unfccc.int/files/press/news_room/press_releases_and_advisories/application/pdf/pr_cop15_20091219.pdf.

¹¹ Appendix II, "Nationally appropriate mitigation actions of developing country Parties," retrieved 25 March 2010 from <http://unfccc.int/home/items/5265.php>.

trust that their richer counterparts are bargaining in good faith, developing countries will be unwilling to abandon the Kyoto Protocol track.

Neither is it clear how the Copenhagen Accord can impact the negotiating process that began with the Bali Action Plan and proceeded for the two years leading up to COP 15 in Copenhagen. One possibility is that the commitments and political compromises reflected in the Accord can be somehow brought into the formal negotiations under the UNFCCC. Indeed, this was the position taken by the European Union, Japan, Russian Federation, the United States and several other developed countries when the AWG-LCA convened for the first time after Copenhagen in April 2010. For the Group of 77 and China, the Copenhagen Accord was, however, a difficult issue: although several developing countries support the Accord, other countries, including Bolivia and Venezuela, continue to oppose it. Differences over the Copenhagen Accord were ultimately reconciled in an agreement to mandate the AWG-LCA's Chair to prepare for June 2010 a new negotiating text that draws not only on the negotiating texts developed by the AWG-LCA in 2009, but also on the work undertaken by COP 15 based on the AWG-LCA's report, with the understanding that this encompasses all work undertaken by the COP, including its decisions. Interpreted broadly, this would arguably also include the Copenhagen Accord. Furthermore, Parties were also invited to submit additional views on the negotiating text by late April—a compromise proposed by the G-77 and China to enable countries supporting the Accord to submit it as input for the new negotiating text.

On the assumption that the current negotiating difficulties will not forever plague the climate regime, Annex A describes the sorts of legal changes to the treaties that might be made in pursuit of fossil-fuel subsidy reform.

All of this suggests that, at least for the immediate future, it is unrealistic to contemplate legal changes to the treaties that could provide an institutional home for fossil-fuel subsidy reform. That is not the end of the story, however. There are ways in which the climate change regime could contribute to the effort without such legal changes; two such options are now described.

4.1.4 Potential mechanisms for subsidy reform and their possible entry points

In the following paragraphs, two potential mechanisms are proposed and discussed in detail:

1. Common actions regarding subsidy reform or contributions to subsidy reform. These could have a legally binding basis or be based on recommendations; and
2. NAMAs by developing countries, possibly with a reformed CDM.

These two mechanisms are discussed, along with the possible entry points for including subsidy reform in the UNFCCC legal framework. One of the questions considered is whether these mechanisms could be accommodated within existing agreements, would require amendments or would need new agreements.

Potential Mechanism 1: Common actions regarding subsidy reform or support of subsidy reform

The UNFCCC Parties, or a subset of them, could agree to implement any number of specific actions as part of their responses to climate change.

These common actions could be policies and measures (PAMs), with progress measured either directly (the impact of the PAM) or indirectly (for example, the change to an energy price). How strictly the PAM would be monitored, reported and verified would need to be agreed: reporting requirements are essential components of any mechanism. The common actions could, alternatively, be supporting actions; for example, countries could agree to publish their energy prices and the support they provide to energy producers, preferably using internationally agreed standards or protocols.

The existing legal framework under the UNFCCC and the Kyoto Protocol leaves it almost entirely to Parties to decide which specific mitigation actions they will take to meet their commitments to reduce greenhouse gas emissions. (For a full overview of previous discussions on subsidies and policies and measures, see Section 4.2.1.) As such, nothing prevents a group of UNFCCC Parties from agreeing among themselves to take certain actions in concert. Such a move would have the advantage of not needing negotiations under the regime that, as noted above, is focused on the post-2012 architecture for the foreseeable future. If the Copenhagen Accord survives in some form as part of that architecture, it may introduce an element of pledge and review to the process of international commitments on climate change. In such a decentralized regime, it would be possible for a group of countries to champion fossil-fuel subsidy reform by agreeing among themselves to feature it as part of their pledges, using agreed metrics and benchmarks. Those countries could then work bilaterally and multilaterally to increase the membership of the “club.”

Much more challenging, but possible given the right circumstances, would be seeking to make fossil-fuel subsidy reform in some way mandatory under the climate regime. Provisions on subsidy reform could also be included in an amended Kyoto Protocol, if that agreement were part of the post-2012 architecture. At present, Article 2.1(a) of the Kyoto Protocol commits Annex I countries to implementing PAMs to meet their emission reduction targets and mentions, among other things, the progressive reduction of phasing out of a number of measures, including subsidies. Article 3.14, backed up by Decision 31/CMP.1, obliges developed countries to prioritize certain actions,

including reducing those subsidies that cause the highest levels of greenhouse gas emissions. A further CMP Decision requiring the rigorous application of these Articles, backed up by agreed actions and timetables, would strengthen the commitment. The Bali Action Plan required “enhancing the implementation of the UNFCCC” and specific provisions relating to subsidy removal would seem to fit this very well.

As noted above, however, fossil-fuel subsidy reform has not been discussed in the lengthy and detailed negotiations mandated under the Bali Action Plan, so successfully introducing any new issue would be an uphill battle. Moreover, any amendments to the Protocol would be legally complex (see Annex A) and politically hard fought.

Among other things, such an initiative would have to overcome established resistance to specifying the types of actions to be undertaken at the national level at anything beyond an illustrative list. As well, some Parties—such as oil exporting countries—may see themselves as economic losers under a multilateral deal to reduce fossil-fuel subsidies, since simultaneous multilateral removal of subsidies would mean increased domestic prices, decreased demand and reduced export revenues (OECD, 2009). As such, the consensus rule within the UNFCCC might effectively preclude amending the Protocol to address fossil-fuel subsidies.

It might be simpler to pursue multilateral agreement at levels less binding than COP or CMP Decisions. A Declaration, Resolution or Recommendation¹² that stressed the importance of fossil-fuel subsidies as one element of the Article 2.1 list would not require amended or new legislation. A Recommendation appears to be the most suitable decision type, although agreements with a voluntary character are not the UNFCCC’s usual way of working.

The basic limitation is that either option would target only Annex I Parties. It is inconceivable that the Kyoto Protocol Article 2.1 mandate could be somehow extended to non-Annex I Parties just for the purposes of fossil-fuel subsidy reform. As such, while potentially valuable, any such initiative would provide only a partial approach to the global challenge.

Potential Mechanism 2: NAMAs, possibly with a reformed CDM

In the existing UNFCCC legal framework, the Clean Development Mechanism (CDM) established under Article 12 of the Kyoto Protocol is the main mechanism through which developing countries engage in climate change mitigation. The CDM provides developing countries with access to finance for projects that reduce greenhouse gas emissions compared with an agreed baseline. Subsidy reform does not fit easily into a project-based mechanism—it has a policy nature. It might be possible to

¹² See Annex A for further details on the COP and CMP decision types.

incorporate subsidy reform into project-based mechanisms indirectly if it could be argued that the savings from CDM projects should be calculated against a baseline of the fuel that would have been consumed if prices were not subsidized. Here, baseline consumption would be lower than if subsidized prices were used, and thus savings would be lower. This basic idea has been discussed under the heading of “policy-based CDM,” but it is still not an accepted form of CDM activity. Ghana, for example, proposed an air conditioner efficiency standard as a CDM “project” but this was withdrawn after a negative reception from the CDM’s Methodology Panel.¹³ The rejection, however, was not on principled grounds, but rather on methodological grounds, leaving the door open for further such policy-based CDMs in the future.

It is conceivable that the CDM in a future climate regime could be more receptive to policy-based CDM. Some formal discussions on reforming the CDM or introducing new market-based mechanisms, such as sectoral crediting, were held during 2009 under both the AWG-KP and AWG-LCA. These negotiations did not, however, reach any conclusions and various options remain on the table.

The idea of “policy-based CDM” has much in common with proposals for a new NAMA mechanism, which would generate tradable carbon credits.¹⁴ Introduced under sub-paragraph 1(b)(ii) of the Bali Action Plan and included in the Copenhagen Accord, the concept and design of NAMAs require further specification and definition. Current discussions categorize NAMAs as (i) those that developing countries undertake autonomously; (ii) those that require support (financial, technical or technology transfer) from developed countries; and (iii) those that would generate marketable credits for emissions reduced. The third option would encounter technical difficulties in defining and calculating baselines, and hence in establishing additionality, that would be much higher than for single projects. Alternatively, funds could be transferred directly from developed to developing countries if some agreed-upon deliverable were met.

Given their wide, undefined nature, it is clear that NAMAs could conceivably incorporate fossil-fuel subsidy reform. They would be most attractive to developing countries if they led to credits and if the measuring, reporting and verification requirements were not onerous. It does appear that some type of NAMA will form part of the climate change regime going forward and that a registry mechanism holding details of countries’ pledged actions is very likely to be agreed. In fact, paragraph 5 of the Copenhagen Accord envisages the establishment of a registry for NAMAs seeking international support.

¹³ See withdrawn CDM methodology NM0072 at http://cdm.unfccc.int/methodologies/PAMethodologies/publicview.html?meth_ref=NM0072.

¹⁴ For a full discussion of potential UNFCCC mechanisms, see Wooders and Nolet (2009).

4.2 Implementation

This section considers how subsidy reform could be implemented. It begins by reviewing the previous discussions and negotiations that have been held around subsidies in particular, and policies and measures more generally, before considering which countries (if any) might champion subsidy reform; the political implications of discussing and implementing subsidy reform; and when implementation could be expected to take place.

4.2.1 *What discussions on subsidies have been conducted so far within the UNFCCC?*

Subsidies and their reforms have never been a priority issue for the UNFCCC and are not so at the present time. An analysis of previous discussions concerning subsidies in particular and policies and measures in general is now presented, the idea being to infer the appetite that the UNFCCC may have for increasing the priority given to subsidy reform in the future. Previous discussions are now summarized into a five-step timeline:

1. When the initial Convention was being discussed and negotiated, the idea of positive or negative lists of technologies or policies and measures was included. These discussions almost certainly included subsidy reform to a minor extent;
2. The Kyoto Protocol, agreed in 1997, included a list of possible specific policies and measures under Article 2.1 for developed countries;
3. Section 3.14 of the Kyoto Protocol also spawned a discussion on the impacts on developing countries of response measures taken by developed countries, resulting in recommendations that developed countries take up a range of policies and measures including subsidy reform. The discussion included two aspects: (i) take the impacts of their response measures into account when formulating climate change policy and report on their efforts to do so; and (ii) demand from developing countries that where negative impacts occur in any event, developed countries should soften the impact through such means as funding, insurance and technology transfer. Subsidy reform was not a major part of these discussions.
4. Policies and measures have continued to be discussed sporadically after the adoption of the Kyoto Protocol. Again, these discussions have not focused on subsidy reform to any extent: there have never been serious and detailed negotiations. Before the Copenhagen negotiations, an SBSTA roundtable in May 2005 was the most recent initiative on policies and measures. The only mention of subsidies in the workshop report was brought up by Saudi Arabia, calling for the removal of coal subsidies. The PAMs focused on during the roundtable are highlighted in Box 4.2. Because the Kyoto Protocol left it to developing

countries to decide how to comply with their quantified emission targets, it was left to countries to decide which policies and measures to follow. The focus has therefore been on sharing experiences and information rather than pushing for international agreements on any particular policy (such as energy subsidy reform). The UNFCCC website includes an overview of the minor amount of work done on policies and measures.¹⁵

5. In the period leading up to Copenhagen, Australia and the United States pushed for “national schedules,” which would have obliged countries to agree upon sets of common policies and measures. Subsidy reform was not part of these discussions.

Box 4.2 Policies and measures focused on at the SBSTA 2005 workshop¹⁶

- a) Market-based instruments, such as the European Union’s ETS and the United Kingdom’s domestic emission trading system
- b) Economic and fiscal instruments and incentives aimed at promoting renewable energy, cogeneration and bio-fuels in transport, such as eco-taxes in Germany and the climate levy in the United Kingdom
- c) Standards and regulations on energy efficiency in buildings and appliances, on waste management and on fluorinated gases, the latter including new European Union legislation on fluorinated gases, Japan’s Top Runner program and Australia’s energy efficiency standards and regulations on fluorinated gases
- d) Voluntary approaches and agreements, e.g., Japan’s voluntary action plan “Wisdom of Industry” and the United Kingdom’s climate change agreements
- e) Research and development for new and innovative technologies and processes, such as renewable energy technologies and hydrogen technology

The summary above has shown that subsidy reform has formed only a minor part of discussions in the UNFCCC. It is clearly too simplistic to argue that, since subsidy reform is explicitly included within the text of the Kyoto Protocol, there is a consensus that countries wish to reform subsidies or that the UNFCCC is therefore a suitable home for reform. In general, attempts to use the UNFCCC to act as a vehicle for pushing specific policies or measures have not been successful.

¹⁵ See http://unfccc.int/national_reports/annex_i_natcom/pams/items/1069.php.

¹⁶ See “Report on the round-table discussion on experiences of Parties included in Annex I to the Convention in implementing policies and measures,” Subsidiary Body for Scientific and Technological Advice, Twenty-third session, FCCC/SBSTA/2005/INF.6, Montreal, 28 November to 6 December 2005, item 12(a) of the provisional agenda, 28 September 2005, <http://unfccc.int/resource/docs/2005/sbsta/eng/inf06.pdf>.

4.2.2 Which countries might champion subsidy reform under the UNFCCC?

Within the UNFCCC process, no country or group of countries has yet made a concerted effort to push subsidy reform. We could draw some conclusions on which countries might be most willing to do so from an examination of countries' actions within other forums. But, at this early stage in the G-20 process, we have little guidance as to the appetite for countries to make serious progress to reform their subsidies.

While it is clearly in the interest of net energy importers to get other net fossil-fuel exporters to reduce their subsidies (in order to reduce world prices for energy), it is not clear that countries will be able to force others to reform their subsidies if they do not consider it to be in their national interests.

Subsidy reform efforts to date have resulted from the efforts of individual countries rather than from an international approach. A key benefit of an international approach is the peer pressure that countries can exert on each other to make progress. As such, a "Friends of" grouping might be useful. There is no indication at this stage whether, or which, countries could join such a grouping, but it would probably start with rich, developed countries who wish to ensure they have no remaining subsidies to their fossil-fuel industries. To this could be added middle-income developing countries that no longer have sufficiently large exports of fossil fuels to continue to subsidize consumers at current subsidy rates.

Of course, countries always have the option of using the UNFCCC within a multi-forum approach to subsidy reform. This option is discussed in Section 5.

4.2.3 Political implications of energy subsidy reform discussions and negotiations

Energy remains key to the economies of the world. Changes to energy policy (including energy pricing policy) and whether energy policy is driven by subsidy reform or otherwise are thus serious issues requiring serious analyses.

The history of energy policy demonstrates that it is jealously guarded as a matter of national sovereignty. Any attempt to usurp this would be likely to cause major political issues.

There is thus likely to be considerable suspicion behind the true motivation of any country's attempt to introduce fossil-fuel subsidy reform into the UNFCCC. This will be exacerbated if the reasons given for subsidy reform are not priorities for all countries. The most pertinent example is climate change: an international agreement on subsidy reform driven by the desire to reduce greenhouse gases would immediately raise the issues of historical responsibility, equity and all the other political

issues within the UNFCCC negotiations. If climate change is an important consideration, other forums would likely end up having to confront the same issues that the UNFCCC has had to. In this case, the UNFCCC would at least have useful experience to which it could point.

Net exporters of oil and gas in the developing world are considered by many to be the major subsidizers of fossil fuels. They also have the most to lose in lost export revenues from other countries' subsidy reforms. Their interests are thus paramount, and the serious discussions on the impact of response measures and possible compensation under Kyoto Protocol Article 3.14 are an inevitable result of this. But compensating oil-rich countries for their economic losses, or even proposing compensatory technology transfer or insurance mechanisms, could prove to be politically impossible for certain developed countries. The Kyoto Protocol Article 3.14 requirements have to be seen, therefore, as a huge liability in considering the suitability of the UNFCCC as an institutional home for fossil-fuel subsidy reform.

The alliances within the UNFCCC—for example, the G-77 plus China—would have to be considered within any political analysis. As an example, the G-20 group of countries that agreed the Pittsburgh Communiqué includes only a limited number of the G-77 plus China group. It might be impossible for some of these to agree to subsidy reform within the UNFCCC.

It is possible that the issue of subsidy reform, with its close links to energy policy, could have too many elements for the UNFCCC to take it on. The discussion of subsidies could divert attention away from more “traditional” UNFCCC topics.

4.2.4 When might we expect implementation?

The UNFCCC process is clearly in a delicate state. The planned-for comprehensive agreement at Copenhagen in December 2009, set up by two years of discussions under the Bali Action Plan, delivered only a substantively weak and legally obscure result—the Copenhagen Accord—with just 12 paragraphs of text. As it was not adopted by the COP, the Copenhagen Accord does not have a formal status under the UNFCCC and its influence on further negotiations remains unclear. In any case, negotiations and discussions to elaborate the post-2012 climate regime will therefore take much longer than the 6 to 12 months some were hoping for pre-Copenhagen. And there remains the clear possibility that the UNFCCC process will stagnate.

Progress on any specific issue—for instance, subsidy reform—is likely to be held up while high-level discussions are held and frameworks put in place. It is difficult to imagine the UNFCCC putting a significant amount of its limited time and effort into single issues within this context.

Legally binding mechanisms that rely on new text within existing agreements may thus be difficult to progress in the short- to medium-term. If they require new agreements, progress would be even slower. Expecting a COP Decision in the near future thus appears unlikely.

Better opportunities of progress in the near future would be offered by non-binding mechanisms. The UNFCCC could issue a Recommendation on subsidy reform or some supporting measure relatively simply and thus relatively quickly. This would, of course, require countries willing to push the idea through the process, the generation of consensus and finding time for negotiations and discussions leading up to and during the COP. NAMAs in some form seem likely to be part of any future climate regime. NAMAs could fit into a non-binding approach, since their precise application is likely to be at the discretion of developing countries rather than being an obligation. Nevertheless, operationalizing NAMAs still requires a wide range of principles and details to be agreed, and these may take a significant amount of time. Furthermore, the outcome of the NAMA process remains uncertain; whether some or all countries would include subsidy reform is another discussion yet to be held.

More positively for implementation, the UNFCCC may wish to demonstrate its relevance and ability to make progress by concentrating its efforts on a limited number of specific issues. Subsidy reform could be one of these issues. This is, however, conjecture—the UNFCCC has not intimated that this is a process it wishes to follow in general nor that subsidy reform would be an issue of interest to it in particular.

4.3 Conclusions

The UNFCCC has a number of strengths that would make it suitable to support subsidy reform. It is a comprehensive forum where 194 countries participate, with a well-developed Secretariat (albeit with limited competencies in the area of subsidies) and schedule of meetings. It is also a natural home for any issue with a climate change focus; any other forum aiming to progress subsidy reform is likely to end up recreating at least part of the UNFCCC's discussions and modalities when considering the issue of climate change.

Subsidy reform has received very little attention to date within the UNFCCC. The most serious attention has concerned Article 3.14 of the Kyoto Protocol and its attempts to prioritize the actions developed countries should take to reduce their greenhouse gas emissions, and potential remedies for the impacts of developed countries' mitigation actions on other countries (Articles 4.8 and 4.9 of the Convention). Both Articles include a reference to subsidy reform but do not prioritize it against a range of other policies and measures. Similarly, discussions surrounding implementation of the Articles have not focused on subsidy reform in particular.

The UNFCCC does have some flexibility in how it operates, and thus in how it might assist with the reform of subsidies. It is too simplistic to argue that, since subsidy reform is explicitly included within certain texts (e.g., Article 2.1(a)(v) of the UNFCCC's Kyoto Protocol¹⁷ and the Decisions resulting from Article 3.14¹⁸), there is a consensus that countries wish to reform them and that the UNFCCC is the most suitable home for reform or that subsidy reform is a priority. Indeed, the UNFCCC Parties have to date shied away from requiring any specific policies or measures, with freedom to meet commitments assumed to be a matter of national sovereignty.¹⁹ Furthermore, what discussion there has been on policies and measures has not been focused on subsidy reform, with other options having received more attention. Moreover, the promise of compensation for the impacts of response measures held out by Kyoto Protocol Article 3.14 means that subsidy reform under the UNFCCC might be accompanied by demands that many Annex I Parties would find politically impossible.

To expect the UNFCCC to develop legally binding commitments to reform subsidies in the near future appears highly optimistic. Rather, there are a number of mechanisms that could be followed. In part, these depend on how post-Copenhagen discussions progress, including with the Copenhagen Accord. The two key options identified are:

1. Common actions regarding subsidy reform or supporting it. Countries could agree that subsidy reform, or actions supporting it, are policies and measures that must be included under a common list of actions. This option, in common with other policies and measures, is likely to be concentrated within developed countries. While such an option could be made legally binding, a COP Recommendation, having a voluntary nature, would be significantly easier and quicker to implement. Decisions of this type would not require countries to either meet commitments or to report on their progress.
2. NAMAs, possibly with a reformed CDM. NAMAs are perhaps the key future mechanism through which subsidy reform could progress in developing countries.²⁰ NAMAs, if agreed and progressed within the UNFCCC, could also include a reformed CDM in some way. They would involve developing countries putting forward policy commitments in order to demonstrate they are reducing their greenhouse gas emissions in lieu of national emissions

¹⁷ Kyoto Protocol Article 2.1(a)(v) calls for “Progressive reduction or phasing out of market imperfections, fiscal incentives, tax and duty exemptions and subsidies in all greenhouse gas emitting sectors that run counter to the objective of the Convention and application of market instruments.”

¹⁸ See, for example, Decision 31/CMP.1.

¹⁹ Noting that the discussions around trade measures do show that countries may have to coordinate policies and measures to some extent if progress is to be made on some issues (in this case, around the competitiveness of energy-intensive industries).

²⁰ A range of other mechanisms may also result, for example, a reformed CDM that could extend to policies.

targets. These policy commitments could be supported by developed countries, either by technical assistance or through financial transfers including the carbon market purchasing credits generated by a country performing better-than-an-agreed baseline.

Both of the options are at present largely theoretical: the requisite discussions and negotiations have not been held, and we are far from detailed implementation plans. Progress on either option depends on progress of the UNFCCC process as a whole. It will also require a group of countries to “champion” the issue of subsidy reform. No group of countries is currently playing this role, but a “Friends of” group or something similar is not inconceivable. A formal, visible group of such countries has yet to materialize but there are reasons to suspect one could do so, because while there are clear sensitivities around subsidy reform (notably the issues of the importance of energy policy and of economic compensation to energy producers), subsidy reform retains a compelling logic: it has the potential to deliver economic, environmental and social benefits to the country instituting the reforms.

The G-20 subsidy initiative has been placed under the G-20’s “Energy Security and Climate Change” program of work. This immediately demonstrates that there are issues other than climate change that concern countries considering subsidy reform. These issues may also be more important than climate change in at least some of the countries considering subsidy reform: other motivations for subsidy reform include improving the country’s financial position, allocating resources more efficiently and local pollution issues. The UNFCCC, concentrating on climate change directly and considering sustainable development indirectly, may thus not find itself naturally at the centre of the subsidy-reform debate: subsidy discussions have tended to strongly involve finance ministries to date and we can expect this to continue.

The UNFCCC may have a role to play in subsidy reform. For this role to be significant would require a major change in the importance ascribed to subsidy reform within the process, backed up by suitable new mechanisms. A number of countries championing the process would be paramount. Where such countries would push for action, and how likely this action is to be agreed by the group of 194 countries within the UNFCCC process, remains unknown at this stage. There is a clear need for more work to better define the options and identify the political processes needed to support their implementation.

5.0 Taking leadership from the G-20

5.1 The G-20 mandate

In September 2009, Leaders of the Group of Twenty (G-20) major industrialized and developing countries reached a milestone when they announced a commitment to reform inefficient fossil-fuel subsidies. Drawing on research by the OECD and IEA, Leaders recognized that “inefficient fossil-fuel subsidies encourage wasteful consumption, distort markets, impede investment in clean energy sources and undermine efforts to deal with climate change.” Within this context, G-20 Leaders committed to “rationalize and phase out over the medium term inefficient fossil-fuel subsidies that encourage wasteful consumption” (G-20 Leaders, 2009).

In doing so, they acknowledged the challenges of populations suffering from energy poverty and the need to prevent adverse impacts on the poorest, adding, “as we do that, we recognize the importance of providing those in need with essential energy services, including through the use of targeted cash transfers and other appropriate mechanisms” (G-20 Leaders, 2009).

To take the initiative forward, Leaders made a number of requests. They asked their Energy and Finance Ministers to prepare implementation strategies and time frames, based on national circumstances, and report back to Leaders at the next Summit, scheduled for 26-27 June 2010 in Toronto, Canada. They asked international financial institutions (IFIs) to offer support to countries in progressing the initiative. And they asked international organizations, namely the IEA, OPEC, OECD and World Bank, to provide an analytical report on the scope of energy subsidies and with suggestions for implementation, to be reported to Leaders at the June 2010 Summit. Lastly, Leaders called on all nations to adopt policies that will phase out inefficient fossil-fuel subsidies worldwide.

The communiqué is somewhat vague on the scope of subsidies to be included within the initiative. Terms such as “inefficient” and “wasteful consumption,” combined with the reference to the IEA and OECD studies that provided data and analysis on consumption subsidies, initially suggested that the commitment was focused on reducing consumption subsidies in developing countries. But in discussions between energy and finance experts, officials have since clarified that producer subsidies should be included. In the absence of an agreed definition of what constitutes a fossil-fuel subsidy, governments have quite a wide scope for excluding subsidies from their reform efforts. In addition, G-20 Leaders explicitly excluded subsidies for “clean energy, renewable, and technologies that dramatically reduce greenhouse gas emissions”; the latter category relates to subsidy programs such as research into carbon capture and storage.

The existing mandate does not provide for an ongoing mechanism to ensure fossil-fuel subsidy reform remains on the agenda beyond the report-backs of Ministers and IGOs to G-20 Leaders in

June 2010. There is some risk that fossil-fuel subsidy reform could drop off the agenda as the Chair of the G-20 rotates to members who do not consider it a priority. The Chair of the G-20 revolves each year—usually one Chair per year, although for 2010 South Korea and Canada are jointly sharing the role. The Chair is supported by the “Troika” (the Chairs from the previous and following years) to ensure some continuity of work and management across host years. The United States championed the initiative at the Pittsburgh meeting in 2009, but future agendas and management will be determined by the Troika (for 2010 it is comprised of the United Kingdom, South Korea and France). There may be increased reluctance to give fossil-fuel subsidy reform priority on the G-20 agenda, if at all, unless a more formal mechanism is created.

5.2 The G-20 as political leader, delegating tasks to other organizations

The G-20 was established in 1999 to bring together important industrialized and developing economies to discuss key issues in the global economy. It has been designated by G-20 members to be the primary forum on international economic cooperation, contributing to the strengthening of international financial architecture and facilitating dialogue on national policies and international cooperation to support growth and development worldwide.

The G-20 is largely geared toward high-level meetings of Heads of State, Finance Ministers and Central Bank Governors. Although Finance Ministers and Central Bank Governors normally meet once a year, the intensity of dialogue and engagement has substantially increased—the schedule of events for 2010 includes two Leaders Summits (in June in Toronto and in November in Seoul), four meetings of Finance Ministers and Central Bank Governors, and two Deputies’ meetings.²¹

The G-20 does not have a formal secretariat or permanent staff to provide administrative support for meetings and initiatives. Rather, it relies on government officials within the membership to undertake technical work in the form of workshops, reports and case studies on specific subjects in order to provide Ministers with analysis and policy options. This technical work is complemented with requests for assistance to other international organizations. For example, G-20 Leaders requested support from four inter-governmental organizations—the IEA, OPEC, OECD and World Bank—to provide research and analysis on fossil-fuel subsidies.

The high-level political leadership and commitment demonstrated by the G-20 has provided the necessary momentum for national governments and international organizations to put fossil-fuel subsidy reform into action. With a very broad economic agenda and few resources dedicated to supporting G-20 meetings and initiatives, however, it may be necessary for the G-20 to delegate ongoing roles to other organizations to assist with tasks such as research, analysis and information

²¹ For more information on the G-20 and the schedule of meetings for 2010, see http://www.g20.org/about_what_is_g20.aspx.

sharing, to ensure effective implementation of the political commitment laid out in Pittsburgh to reform fossil-fuel subsidies.

5.3 Roles within the international community

In order to support national governments within the G-20, the Asia-Pacific Economic Cooperation (APEC)²² and other like-minded countries in reforming their fossil-fuel subsidies, the international community may need to fulfill a number of roles:

- Provide comprehensive membership of international reach.
- Provide data, research, economic and political analysis, and policy advice covering the characteristics and magnitude of fossil-fuel subsidies, their impacts, challenges and best practice for subsidy reform.
- Offer technical assistance and capacity building to governments that need help, for example, to estimate subsidy types that require complex estimation methodologies or to design effective and targeted cash-transfer mechanisms.
- Provide financial assistance to help developing countries establish the mechanisms and institutions necessary for effective subsidy reform.
- Undertake monitoring and evaluation, which is an essential element of ensuring governments are meeting their subsidy-reduction commitments, and inform further policy development.
- Provide a forum for building consensus and negotiating an international agreement on fossil-fuel subsidies, which may be required in the longer term.

There are a number of IGOs, IFIs and NGOs that fulfill many or some of these functions. There is no single organization that currently offers the capacity and resources to take on a secretariat function without also bringing some limitations. This section considers each of the main organizations working in the field, the type of support these organizations can offer national governments, and the limitations for taking on full secretariat functions.

²² The APEC Leaders made a very similar commitment to that of the G-20 Leaders. See APEC Leaders' Declaration, "Sustaining growth, connecting the region: The 17th APEC Economic Leaders' Meeting," Singapore, 14-15 November 2009, retrieved 16 March 2010 from http://www.apec.org/apec/leaders_declarations/2009.html.

5.3.1 Inter-governmental organizations (IGOs)

International Energy Agency (IEA)

The International Energy Agency has existing capacity and resources to provide data and analysis on fossil-fuel subsidies. The *World Energy Outlook 2008* provided estimates for consumer subsidies for fossil fuels and electricity in the 20 largest subsidizing, developing countries. In response to the G-20 request for information, the IEA has expanded this data set to around 40 countries, including all the G-20 members, and plans to use its world energy model to analyze the impacts of subsidy reform. The IEA also undertakes in-depth reviews of its members' energy policies and, on occasion, the energy policies of non-members. These reviews include information about subsidy programs where relevant. For example, the review of Indonesia's energy policies included detailed analysis of its fossil-fuel subsidies (IEA, 2008). The IEA also compiles estimates of subsidies to energy research and development in its member countries.

The energy subsidy estimations provided by the IEA are limited in that they only cover subsidies captured by the "price-gap" methodology and only cases in which the domestic price is below the reference price; the data cover a limited number of countries; the data are provided on an ad hoc basis; and the data and assumptions underlying the estimations are not yet transparent. Continuing to expand this research and analysis may fit within the IEA's mandate, but its membership is limited to a subset of the OECD's and it is perceived by some developing countries to follow a developed-country agenda (Laan, 2010). The IEA's membership could impose political restraints or slow some work programs (e.g., estimating producer subsidies within its membership) and could lack buy-in from developing countries.

Organisation for Economic Cooperation and Development (OECD)

At the time of the G-20 Leaders Summit in Pittsburgh, the OECD held little information on fossil-fuel subsidies as it had delegated data-gathering functions to the IEA. It does, however, have considerable experience in measuring producer subsidies in other sectors. The OECD provides policy tools and advice on reforming environmentally harmful subsidies and has done some economic modeling of the impacts of fossil-fuel subsidy reform on trade, gross domestic product and greenhouse gas emissions. The OECD is considering increasing its work program on fossil-fuel subsidies in response to G-20 needs for more research and analysis.

In terms of providing a potential secretariat function for the G-20, the OECD membership presents similar limitations as outlined for the IEA. Having limited membership of national governments could provide political restraints for undertaking some research, analysis, monitoring and evaluation

functions. Its limited membership could also limit the involvement of non-members, notably developing countries that may require financial and technical assistance and capacity building.

Organization for Petroleum-Exporting Countries (OPEC)

OPEC offers a coordination role among its members of oil-exporting countries, in order to stabilize the market. It undertakes research, analysis and shares case studies of best practice that could support subsidy reform in its member countries. Expanding OPEC's role would require building up additional capacity and experience with subsidy-estimation methods, improving transparency of information provision and obtaining the necessary buy-in from its membership.

United Nations Environment Programme (UNEP)

UNEP has undertaken a considerable body of work on fossil-fuel subsidies, including how energy subsidies are defined and measured, assessing their magnitude and impacts, notably through case studies in developing countries, and the challenges of reform. Although UNEP's in-house research capacity on fossil-fuel subsidies is limited, it could be effective in widely disseminating information and providing technical assistance and capacity building through its network of regional offices. Its comprehensive membership could benefit both developing and developed countries in offering an informal venue to discuss and engage on these issues.

5.3.2 International financial institutions (IFIs)

IFIs could support fossil-fuel subsidy reform at both the national and international levels. On the national level, IFIs could provide technical assistance to collect data and assess the economic and fiscal impacts of fossil-fuel subsidies, provide advice and best practice on the reform of subsidies, provide financial and technical assistance in the design and implementation of flanking policy measures (such as direct cash transfer programs for the poor) and provide ongoing support to help governments respond to increasing fuel prices (IMF, 2008).

In particular, organizations with comprehensive membership, like the International Monetary Fund (IMF) and World Bank, might be best placed to offer support for the G-20 or other countries' commitments to undertake fossil-fuel subsidy reform. One drawback to both the IMF and the World Bank is that they are perceived by many developing countries to be pursuing a developed-country agenda, and their "one-dollar-one-vote" voting structures makes this perception hard to refute (Banking Information Centre, 2010). If, in the longer term, international collaboration moves toward negotiating an international agreement on fossil-fuel subsidies, these discussions might be better held within a more appropriate negotiating forum such as the WTO.

5.3.3 Non-governmental organizations (NGOs)

Independent NGOs such as the International Institute for Sustainable Development (IISD), World Wildlife Fund (WWF), Earth Track and Greenpeace have also undertaken detailed research and analysis, including estimating subsidies, assessing their impacts and providing case studies of best practice for reform. Without the political constraints of government membership, NGOs can react swiftly to fulfill emerging research needs and provide independent analysis for monitoring and evaluating progress of reform efforts.

In addition, NGOs play a vital role in raising awareness and gathering momentum for international consensus on the importance of subsidy reform. For example, the research, analysis, awareness raising and lobbying undertaken by NGOs such as the WWF were essential for building consensus among the WTO membership in the process for obtaining a Ministerial mandate to negotiate disciplines for fisheries subsidies.

NGOs often face funding and resource limitations for their work programs, however. In addition, governments can be reluctant to delegate functions such as monitoring and evaluation to independent and transparent organizations over which they have little or no influence.

5.3.4 Collaborative, multi-forum approach

There is no one organization whose current activities offer a full secretariat-type function to support fossil-fuel subsidy reform. If speed is of the essence, a much more comprehensive and beneficial approach could be provided by the international community working collaboratively to complement the work already being done on fossil-fuel subsidy reform. Table 5.1 provides an overview of the roles the key organizations can offer in terms of research capacity, transparency, membership and flexibility.

Table 5.1 The Global Subsidies Initiative's (GSI's) assessment of organizational capacity to support fossil-fuel subsidy reform.

Organization	Criteria					
	Comprehensive membership or international reach	Strong research and analysis capacity	Ability to offer technical assistance	Provision of financial assistance	Undertaking of monitoring and evaluation	Provision of a negotiating forum
Development banks						
IMF	X	X	X	X	X	
World Bank	X	X	X	X	X	
International organizations						
IEA		X	X		X	
OECD		X	X		X	
OPEC		X	X			
UNFCCC	X	X	X			X
UNEP	X	X	X			
WTO	X	X	X		X	X
Independent organizations						
Earth Track		X	X		X	
GSI		X	X		X	
Greenpeace		X	X		X	

Organizations such as the IMF, World Bank and UNEP have significant advantages in their comprehensive membership and ability to provide technical assistance through their networks of regional offices. IGOs, including the OECD or IEA, have very specific research strengths, including expertise in subsidy estimation methods and developing economic models to assess subsidy reform. NGOs play a vital role in reacting swiftly to emerging research needs of governments and providing an independent monitoring and evaluation role to track progress of subsidy reform.

These roles will likely evolve as international collaboration strengthens and organizations develop new capacities and take on new mandates to progress down the roadmap toward a negotiated agreement on fossil-fuel subsidy reform.

6.0 A Roadmap for international cooperation

6.1 Overview

International cooperation could significantly advance fossil-fuel subsidy reform. Such cooperation would be supportive of domestic reform measures, adding to them rather than being an alternative. Even in the absence of international cooperation, however, some progress on fossil-fuel subsidy reform could still be achieved.

The Roadmap shown in Figure 1.1., reprinted again herein as Figure 6.1., plots a course from the current situation to the longer term, detailing the steps required during the short term (next 12 months) and the medium term (1-3 years). A key lesson from previous successful initiatives is that an incremental approach combining technical work and awareness building holds much promise. Pascal Lamy, in an address to a Trade, Energy and Environment conference in October 2009, noted three important steps for introducing a new topic to the WTO: gathering facts, initiating discussion, and then negotiating the rules (Lamy, 2009b). This process can be applied to engaging the UNFCCC and other institutions.

The Roadmap plots the route toward a negotiated agreement on fossil-fuel subsidy reform. Such an agreement would be supported by a dedicated secretariat, with a clear mandate and funding arrangements.

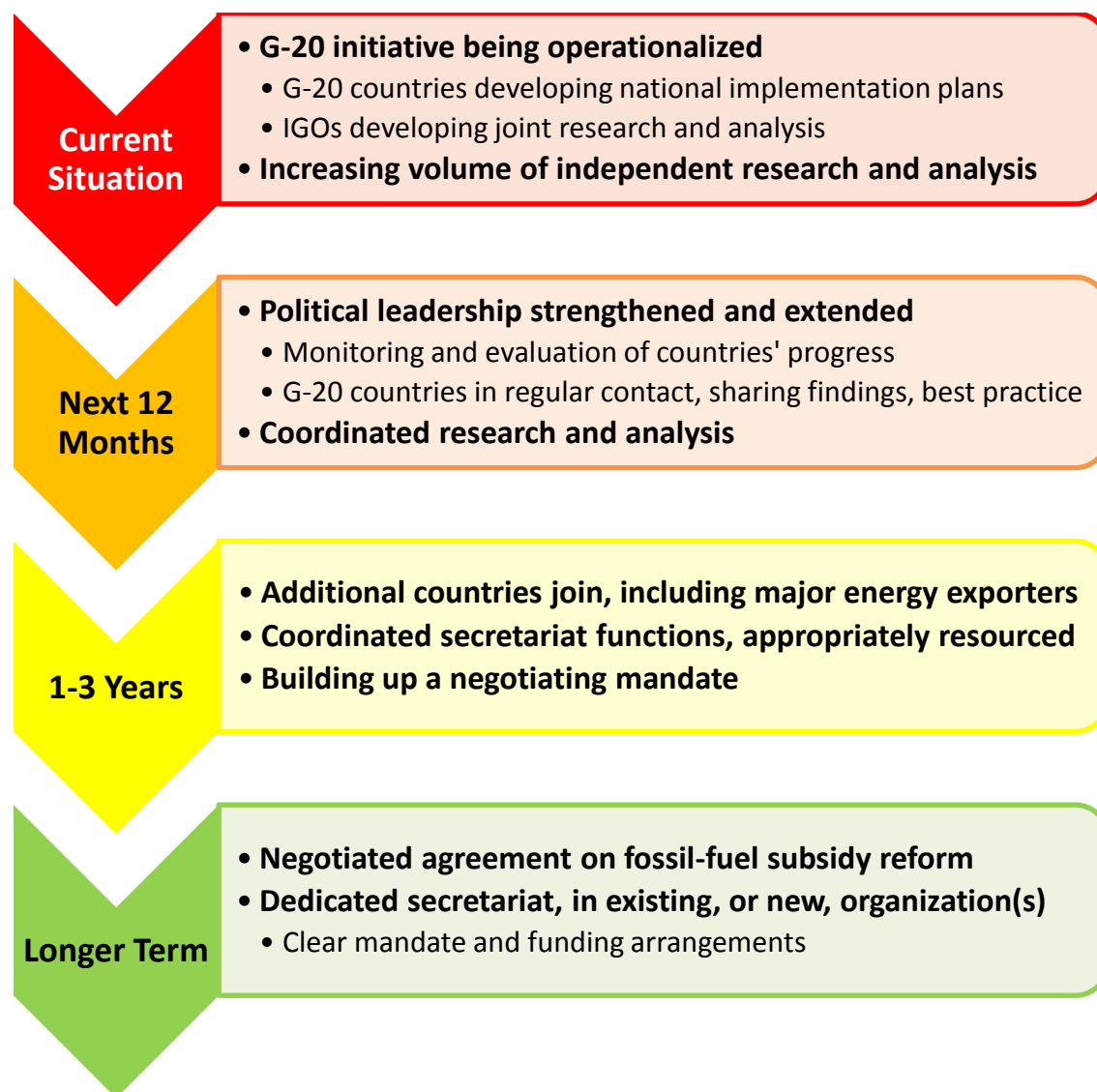
6.2 The current situation: Some progress already

Reaching the ideal endpoint of the Roadmap is not essential to progress reform. The current situation already sees countries becoming increasingly aware of the issues raised by fossil-fuel subsidies, with the G-20 providing political leadership and IGOs, NGOs and other independent organizations and individuals providing an increasing volume of research and analysis.

The current situation looks significantly more optimistic for fossil-fuel subsidy reform than the situation a year ago. The G-20 initiative is being operationalized. The G-20 has specifically mandated four IGOs—IEA, OECD, OPEC and the World Bank—to prepare a Joint Report for their Leaders Summit in Toronto in June 2010. Also for this meeting, it has charged its members to develop draft national implementation plans detailing how they will “rationalize and phase out over the medium term inefficient fossil-fuel subsidies that encourage wasteful consumption.”

The current situation gives reasons for optimism but is only the start of a framework to join up the activities of the wide range of actors in, and entering, the field.

Figure 6.1 A Roadmap for international cooperation



6.3 Next 12 months: Strengthening, extending and coordinating

The G-20's work program on fossil-fuel subsidies extends only to June 2010, but expectations are that they will extend it to the end of 2010 (see Section 5.1). There is an expectation, but no guarantee, that the G-20 will continue to provide political leadership on this issue.

Were other countries to lend their support to the G-20, and were other forums to become more involved, the risk of a decline in leadership could be reduced and even reversed. APEC has already made a similar commitment as the G-20; one idea could be for a “Friends of” group to form, noting how the “Friends of Fish” group was a key component of raising the profile of fish subsidies reform within the WTO and the subsequent negotiations.

Two key activities need to be progressed over the next 12 months:

1. The momentum behind countries’ planned activities needs to be built up. Countries’ plans under the G-20 initiative are not yet public, and no formal or informal mechanism has yet been specified to monitor and evaluate these plans (see Box 6.1 for a review of the issues). Countries’ progress would also be assisted by the exchange of findings and best practice. Bringing in more, and more formal, secretariat resources might assist progress. Such resources could be located within a range of organizations—Section 5.3 notes that IFIs, IGOs and NGOs all have current capabilities that could be brought to bear.
2. Good quality data and analysis on the scale of subsidies, their impacts and the political economy of reform remain barriers to progress. The next 12 months will ideally see the joint work of the four IGOs for the G-20 acting as the standard bearer: there is a clear advantage in the disparate actors in the field working in a complementary fashion. Coordination need not be heavily formalized and directed, but is nonetheless vital.

Box 6.1 Establishing an international reporting and review mechanism

Establishing standardized and regular reporting on fossil-fuel subsidies and an international framework for monitoring them is the first step on the path to reform. Options could include:

- National reporting to G-20 Summits and peer review;
- Improving compliance with notification obligations under the WTO's Agreement on Subsidies and Countervailing Measures;
- Establishing a secretariat to share information and reports; or
- Delegating functions to existing organizations:
 - membership-based inter-governmental organizations, and/or
 - independent non-governmental organizations.

For example, this could follow the model of the OECD's "Global Forum on Transparency and Exchange of Information," which establishes a global monitoring and peer-review process on tax matters; however, informal peer-review processes and peer-to-peer exchanges of information, including best practice, are often more effective in promoting reform than rules-based agreements (Laan, 2010). A process that places more emphasis on dialogue and exchange between relevant national policy officials results in advice that is perceived to be more user-friendly and practical.

6.4 1-3 years: Embedding and building for a future agreement

The Roadmap envisages the required tasks over the next 12 months being continued and for the issue of fossil-fuel subsidy reform to become embedded within countries' policies and plans. The G-20's membership largely includes the main consumers of fossil fuels but excludes many of the most important fossil-fuel producers. It is within these countries that the most significant impacts of fossil-fuel subsidy reform are likely to occur, both from changes to their own pricing and energy policies and also from reform in other countries. There is little doubt that the involvement of these critical countries, perhaps notably the members of OPEC, would considerably strengthen international cooperation.

International cooperation would also be strengthened by moving from an ad-hoc, partially voluntary, provision of secretariat functions to a more formal structure. This will require organizations to be mandated to perform tasks and provided with the appropriate resources to do so. Who these organizations are, and who resources their activities, could be resolved in many ways. Activities in the medium term should also focus on preparing the ground for future negotiations on an agreement. This will require countries championing the cause and, probably through relatively small groups of like-minded countries, building up the steps needed to secure a mandate to allow negotiations to be set up within the WTO, UNFCCC or another forum.

6.5 Longer term: A negotiated agreement on fossil-fuel subsidy reform

The ideal endpoint would be a negotiated agreement, housed within a single institutional home. While it is difficult to imagine such an agreement being negotiated from the current situation, successful conclusion of the steps covered in the next 12 months and 1 to 3 years should set up the possibility of formal negotiations.

A dedicated secretariat is also indicated, ideally housed within a single institution or cooperating regional institutions. But where would such an agreement and secretariat be housed?

The obvious contender for negotiating an agreement on fossil-fuel subsidies remains the WTO, with its wide membership, compliance capabilities, well-established dispute settlement mechanism and core role in promoting subsidy reform, provided it can extend the negotiating mandate beyond those subsidies that are trade-distorting to include economically-distorting and environmentally-harmful subsidies. The need for secretariat support to advance fossil-fuel subsidy reform goes beyond the role of the WTO secretariat, however.

Other organizations could provide a complementary secretariat role including research and technical support, capacity building, financial support, awareness raising and consensus building. This paper concludes that they must have either very wide international membership or be fully independent; this seems to steer away from organizations that, whilst having considerable strengths, have limited memberships (e.g., the OECD, IEA and OPEC).

A second obvious contender is clearly the UNFCCC, since climate change is recognized as a key rationale for reform by many countries. For its role to be significant would require a major change in the importance ascribed to subsidy reform within the UNFCCC process, backed up by suitable new mechanisms. A number of countries championing the process would be paramount. Where such countries would push for action, and how likely this action is to be agreed by the group of 194 countries within the UNFCCC process, remains unknown at this stage. There is a clear need for more work to better define the options and identify the political processes needed to support their implementation. The UNFCCC is unlikely to be able to provide anything more than a supporting role, at least in the medium term.

An independent organization, for example an NGO, remains an option. It may be more nimble and responsive to progressing the issues, but would have to demonstrate its credibility and objectivity to the client countries it would serve.

A further possibility would be a multi-forum approach, with a number of organizations hosting agreements and providing secretariat functions. For example, the Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries provides a model for a formal collaboration between international organizations²³ to support governments in developing and implementing their economic growth and poverty reduction strategies. Political alliances and common interests could be transferable between forums, on an informal rather than conditional basis (e.g., countries would not be able to demand that certain changes are made to the UNFCCC's regulations if a certain provision was agreed in the WTO). Although there would be difficulties in coordination, this may prove to be the most realistic way forward. International politics are likely to be a key driver. If the key countries on the international scene conclude that more progress could be made, and their interests better served, outside multilateral processes such as the UNFCCC and WTO, then we could expect to see processes such as the G-20 subsidies initiative gain more prominence. Institutions would offer what they were able to in terms of commitment and resources.

²³ Collaboration is among six organizations: the IMF, International Trade Centre (ITC), United Nations Commission on Trade and Development (UNCTAD), United Nations Development Programme (UNDP), World Bank and WTO. For more information about the Integrated Framework, go to <http://www.integratedframework.org/about.htm>.

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