Redirecting Public Subsidies for Fossil Fuels in and from Annex 1 Countries

Continuing to pour trillions of dollars into fossil-fuel subsidies is like investing in sub-prime real estate. Our carbon-based infrastructure is like a toxic asset that threatens the entire portfolio of global goods - from public health to food security. We must direct investment away from dirty energy industries. - Secretary-General Ban Ki-moon, World Business Summit on Climate Change, May 24th, 2009

Many global leaders including UN Secretary General Ban Ki Moon, Sir Nicholas Stern, Al Gore, and John Browne the former Chief Executive of BP have all spoken out against the ongoing practice of subsidizing fossil fuels with public funds. The Obama Administration has proposed eliminating domestic subsidies to the oil and gas industry in the US.

This brief focuses on fossil fuel subsidies in and from Annex 1 countries only. While there are substantial fossil fuel subsidies within and from Non Annex 1 countries, many of these subsidies are designed to improve energy access for the poor. *In addition, it is important that Annex 1 countries lead in eliminating their subsidies to fossil fuels, as language in the Kyoto Protocol already calls on them to do so.*

Further research is needed to fully quantify the scale of ongoing and historical Annex 1 subsidies to fossil fuels. However, on the basis of available data, ***annual subsidies to fossil fuels in Annex 1 countries can be credibly and conservatively estimated at $67 billion.***

Whatever the final number, establishing the principle that public money should no longer be used to support the fossil fuel industry, and should instead be used to finance a clean energy transition and adaptation is a key point. Establishing that principle, at this time, is much more important than fighting over the number.

Sources & Scale of Subsidies to Fossil Fuels in Annex 1 Countries

Subsidies to the fossil fuel industry come from a variety of sources, in a variety of forms. A fossil fuel subsidy is *any government action that lowers the cost of fossil fuel energy production, raises the price received by energy producers or lowers the price paid by energy consumers.*

Table 1: Types of energy subsidy

Government intervention	Example	How the subsidy usually works: lowers cost of production	raises cost of production	lowers price to consumer
Direct financial transfer	Grants to producers	•		
	Grants to consumers			•
	Low-interest or preferential loans to producers	•		
Preferential tax treatment	Rebates or exemptions on royalties, duties, producer levies and tariffs	•		
	Tax credit	•		•
	Accelerated depreciation allowances on energy-supply equipment	•		
Trade restrictions	Quotas, technical restrictions and trade embargoes		•	
Energy-related services provided directly by government at less then full cost	Direct investment in energy infrastructure	•		
	Public research and development	•		
Regulation of the energy sector	Demand guarantees and mandated deployment rates	•	•	
	Price controls		•	•
	Market-access restrictions		•	

Source: UNEP, 2002

Production subsidies are more prevalent in Annex 1 nations, while consumption subsidies, often designed to improve access to energy and mobility, are more common in Non Annex 1 countries. This brief is therefore primarily concerned with production subsidies.

Many, if not most, of the subsidies in Annex 1 nations support the producers of fossil fuels by lowering the cost of production. Instead of making the polluter pay, Northern governments and taxpayers are paying polluters.

Multilateral development banks and export credit agencies continue to be a major source of funding for the production of fossil fuels globally. These agencies use Northern tax dollars to lock developing countries into carbon intensive paths – thus working at cross purposes with the goals of UNFCCC. In some cases projects help provide power for local needs, but in many cases (>80% of supported oil projects) funds are provided which support the extraction of fossil fuels for export to Northern markets.

These international subsidies amount to at least $10 billion annually over the last 8 years.[1] Of great concern is the fact that subsidies to fossil fuels, and to coal in particular, seem to be rising sharply in recent years. The World Bank for instance, saw its financing for fossil fuels increase by 102% in FY08, and an amazing 648% for coal alone in the same year.[2]

Estimates of the value of domestic subsidies vary widely. For example, in the United States alone estimates of the value of federal subsidies to the domestic oil industry (excludes coal) range from *$31.6 billion in public dollars over the next five years (roughly $6 billion a year)*, *to an* *amazing $39 billion annually.* There are several reasons for this discrepancy. First, accounting methods vary. Second, while environmental and consumer groups tend to calculate the total amount of revenue to the American taxpayer that these subsidies cost, others note that “many subsidies have a higher value to recipients than their direct cost to the government.” Finally, the higher estimate includes a conservative portion of defense spending, but does not include any of the costs associated with the Iraq war (more info on defense subsidies to oil here).

Both numbers include modest estimates of how much “royalty relief” costs US taxpayers. Neither includes any amount of international subsidies.

Estimates of OECD (which roughly translates to Annex 1) domestic subsidies to fossil fuels, are also highly variable. A sampling:

Source	Year Published	Estimated A1(OECD) Fossil Subsidies	Notes
UNFCCC Secretariat *“ENERGY SUBSIDIES…”*	2007	unclear	No information provided for oil and gas subsidies in OECD.
UNDP, UNDESA, World Energy Council: *World Energy Assessment 2004 Update*[3]	2004	$57 billion / yr	
UNEP and OECD / IEA: Reforming Energy Subsidies	2002	$10 billion	Estimate based on 1997 World Bank report
UNEP 2008: Reforming Energy Subsidies	2008	unclear	Focus is on non-OECD consumption subsidies
IEA, World Energy Outlook 2006	2007	$20-30 billion	Specifically only OECD production subsidies. Original source for estimate unavailable.
OECD, Koplow, Douglas, *Subsidies and Sustainable Development: Political Economy Aspects*	2007	$49 billion	US only
Pershing, Jonathan et. al., *Removing Subsidies: Leveling the Playing Field for Renewable Energy Technologies*[4]	2004	$57 billion / year	Sourced from UNDP, UNDESA, WEC above

The $57 billion annual figure from UNDP, UNDESA, and the World Energy Council is well sourced and appears to be sound methodologically, although it does not include international subsidies via multilateral banks, export credit agencies, or other bilateral agencies. It does not include any money from defense spending. This figure was generated prior to the 2005 US Energy Bill which contained billions[5] in additional subsidies to the fossil fuel industry. It also does include any of the recently emerging subsidies for so-called “CCS ready” and other advanced fossil technologies. *Therefore, $57 billion annually is certainly a low estimate, but we will combine it with $10 billion annually in international OECD subsidies to reach an estimated $67 billion annually in OECD fossil fuel subsidies that should be phased out and redirected to international climate finance.*

Legal Precedents for Binding Language

The Kyoto Protocol and subsequent decisions of the Parties already call on developed member countries to reduce fossil fuel subsidies as a matter of priority. And a number of other international agreements have also used subsidy limitations to achieve their stated purposes.

Article 2.1 of the *Kyoto Protocol* requires Annex I countries[6] to implement "policies and measures" to achieve their emission limitation and reduction commitments. While Article 2.1 does not require these countries to undertake any specific policy or measure, it lists a range of potential actions that they *could* decide to implement, including:

> (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;[7]

At the COP 11 in Montreal, the Parties to the Protocol strengthened and prioritized this provision. The Parties agreed that Annex II countries,[8] and Annex I countries "in a position to do so" should *give priority* to reducing these market distortions, and to "[r]emoving subsidies associated with the use of environmentally unsound and unsafe Technologies; …"[9]

At the COP 7 in Marrakesh, the Parties also prepared draft guidelines on how Annex I and II countries should report on how they give priority to these actions. However, it does not appear that these draft guidelines were ever formally adopted.[10]

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[1] Research conducted for Oil Change International details $78,541,384,589 in public support from export credit agencies and multilateral development banks from 2000-2008. Known gaps in this data which are due to lack of institutional transparency likely would reveal at least $2 billion more in fossil fuel funding. See also van Gelder et. al, *Public money for fossil fuels in the EU and in three EU member states A research paper prepared for Friends of the EarthEurope,* May 2009; and Bruce Rich, Foreclosing the Future, *Coal, climate and Public International Finance* http://www.edf.org/documents/9593_coal-plants-report.pdf

[2] Heike Mainhardt Gibbs, World Bank Energy Sector Lending: *Encouraging the World's Addiction to Fossil Fuels*, http://www.bicusa.org/en/Article.11033.aspx

[3] http://www.undp.org/energy/docs/WEAOU_full.pdf (see page 73)

[4] http://www.renewables2004.de/pdf/tbp/TBP04-LevelField.pdf

[5] Roughly 8.5 billion annually was provided in that bill to the fossil fuel industry according to Taxpayers for Common Sense.

[6] Annex I countries are developed and transition countries that have taken on emission limitation or reduction commitments under the Protocol.

[7] Kyoto Protocol, § 2.1(a)(v).

[8] Annex II countries are a subset of developed Annex I countries that have committed to provide financing to developing countries to meet the costs of implementing their commitments under the UNFCCC.

[9] Conference of the Parties serving as meeting of the Parties, Decision -/CMP.1: Matters relating to Article 3, paragraph 14, of the Kyoto Protocol, para 5(a) and (b).

[10] COP 7, Draft guidelines for the preparation of the information required under Article 7 of the Kyoto Protocol, §I(H)(13)(a) and (b).