



# HOW TO REIN IN FOSSIL FUEL SUBSIDIES? TOWARDS A NEW WTO REGIME

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# BRUSSELS SCHOOL OF GOVERNANCE REPORT

OCTOBER 2021

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## ABSTRACT

Fossil fuel subsidies have negative consequences on the climate change, public budgets and the transition to an environmentally friendly economy. Nevertheless, governments do not keep up with their commitments to phase out fossil fuel subsidies but misallocate again COVID-19 recovery funds in fossil fuel subsidies. This article provides an analysis of the current obstacles for phasing out fossil fuel subsidies and the potential of the WTO to advance a reform on fossil fuel subsidies. It argues that the WTO can contribute to a fossil fuel subsidies reform by its technical expertise in regulating subsidies, by its broad membership and by its institutional setting. Under the current framework of the ASCM, WTO member can use existing mechanisms, such as the TPRM, to increase transparency in the short term and facilitate discussions on the scope of subsidies while mitigating impacts on vulnerable groups or sectors. This would provide the ground for governments to work towards a new and ambitious agreement to stop producer fossil fuels subsidies and phase out consumer fossil fuels subsidies in the mid-to-long-term. However, the phase out of consumer subsidies needs to be carefully designed and embedded, to avoid unintended consequences on energy access and vulnerable households.

**Keywords:** Fossil Fuel Subsidies Reform, World Trade Organization

### *Acknowledgement*

An earlier version of this article was developed within the framework of the G-2 Conference and Hackathon Challenge 2021 “How to Make the WTO Fit for Future Trade” organized by the Graduate Institute Geneva, Georgetown Law and the Geneva Trade Platform.<sup>1</sup>

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<sup>1</sup> The authors thank Nathalie Bernasconi-Osterwalder and Lourdes Sanchez for their constructive feedback.

## 1) INTRODUCTION

Fossil fuel subsidies (FFS) are undermining international efforts to combat climate change, burdening public budgets and hindering the transition to an environmentally sustainable global economy. According to the International Monetary Fund (2017) efficient fossil fuel pricing in 2015 would have lowered global carbon emissions by 28 percent, fossil fuel air pollution deaths by 46 %, and increased government revenue by 3.8 percent of GDP. Despite several international commitments like the G20 Pittsburgh Communique, the Sustainable Development Goals and the Paris Agreement, key actors do not keep up with their commitments to phase out fossil fuel subsidies but continue to misallocate COVID-19 recovery funds again in fossil fuel subsidies. Why is it so difficult to phase out of fossil fuel subsidies and how can this process be accelerated on an international level? We argue that the World Trade Organization (WTO) has the potential to effectively phase out fossil fuel subsidies. Not only does the WTO provide abundant technical expertise with subsidy regulation and ensure multilateral participation in phasing out fossil fuels subsidies. It also allows the WTO to underpin its commitment to make trade work for sustainable development.

## 2) FOSSIL FUEL SUBSIDIES

Fossil fuel subsidies fall under the WTO Agreement on Subsidies and Countervailing Measures. A subsidy is defined here as “financial contribution by a government or any public body”, where “a benefit is thereby conferred” (WTO 1994). Fossil fuel subsidies have been generally categorized as producer subsidies and consumer subsidies. Producer subsidies exist when producers receive direct or indirect support. However, producer subsidies constitute only a small part of total fossil fuel subsidies. Consumer subsidies present the vast majority of fossil fuel subsidies. They can occur before or after taxation. Pre-tax consumer subsidies exist when energy consumers pay prices below the supply costs. Post-tax consumer subsidies occur if consumer prices for energy are below supply costs plus taxation (IMF 2017). This distinction is important as for instance the UK was claiming in 2015 to not have any fossil fuel subsidies by defining fossil fuel subsidies only as pre-tax consumer subsidies (UK 2015).

## 2a) THE EFFECTS OF FOSSIL FUEL SUBSIDIES

Fossil fuel subsidies are usually intended to enable access to energy, keep end-user prices low, and support domestic energy industries for example to reduce dependence on energy imports. On the one hand, the access to affordable, reliable, and sustainable energy is indeed an important international goal which was enshrined in the Sustainable Development Goal 7.1 in 2015. On the other hand, SDG 7.2 is to increase substantially the share of renewable energy in the global energy mix. This goal is jeopardized by the continued support of fossil fuel subsidies. In addition, fossil fuel subsidies have four main detrimental consequences:

### ***Environmental Harm***

(i) fossil fuel subsidies have negative environmental consequences, as they make excessive consumption of fossil fuels cheap, which leads to higher environmental pressure (see for instance Van Asselt & Kulovesi 2017). The World Bank estimated already in 1992 that global carbon emissions could be reduced by 9 per cent by removing fossil fuel subsidies in a handful of large, carbon emitting countries (Larsen & Shah 1992). While the IEA came up with a similar estimation of 13 per cent global carbon dioxide emissions in 2014 (IEA 2014), Stefanski (2015) even associates 36 per cent of global carbon emissions with fossil fuel subsidies between 1980 and 2010;

### ***Market Distortion***

(ii) fossil fuel subsidies lead to market distortion in the domestic market and international trade in favor of fossil fuels. Direct and indirect government support increases the competitiveness and market shares of the fossil fuel industry at various stages throughout the fossil fuel product value chain. As energy in general, and fossil fuels in particular, is a highly traded sector, the trade impacts are enormous. The Global Subsidies Initiative recently estimated that trade in fossil fuel products alone, excluding energy-intensive industries, represented more than 10 percent of worldwide trade value which lies at 19 trillion USD (Moerenhout & Irschlinger 2020).



### ***Social Inequality***

(iii) while in principle all consumers benefit from fossil fuel subsidies by paying lower prices, fossil fuel subsidies risk to widen income inequalities. According to the IMF (2017) energy subsidies are badly targeted to tackle income inequality, as they benefit primarily populations with high energy-consumption. Del Granado et al. (2012) for example observe that there is a substantial benefit leakage for higher income groups in developing countries, which means that the top income quintile captures six times more subsidies than the bottom quintile. Sdravovich et al. (2014) find that in the MENA region only 1 to 7 percent of diesel subsidies reached the poorest quintile in contrast to 42 to 77 percent reaching the richest quintile. According to Monasterolo & Raberto (2019) fossil fuel subsidies have also higher distributive effects than green subsidies in high income countries. It is important to note though that the distributive effect varies across types of fossil fuels (Couharde & Mouhoud 2020) and that the cut of fossil fuel subsidies needs to be embedded in social programs to prevent any additional financial burden for the poor (Rentschler & Bazilian 2016).

### ***Public Budget Burden***

(iv) fossil fuel subsidies are expensive and burden public budgets as they diverge public funds from other political priorities and create environmental costs and social losses (Victor 2009, Stand 2016). Oosterhuis & ten Brink (2014) even argue that environmentally harmful subsidies like fossil fuel subsidies turns the principle “Polluter Pays” upside down and means “Paying the Polluter”. EU member states paid 50 billion EUR worth of fossil fuel subsidies in 2018 which amounts to 0.4 per cent of the GDP (EU Commission 2020). According to the IEA (2020) the countries who pay the highest percentages of their GDP to fossil fuel subsidies are Iran (18.8 percent), Venezuela (16.7 percent) and Libya (16.7 percent) followed by Algeria, Uzbekistan and Turkmenistan with around 7 per cent.

## 2b) THE PROMISES AND THE STATUS QUO

Diverse groups of governments repeatedly promised in various international fora to phase out fossil fuel subsidies. Already in 2009 at the Pittsburgh Summit the G20 committed “[t]o phase out and rationalize over the medium-term inefficient fossil fuel subsidies” (G20 2009). The Asia-Pacific Economic Cooperation – a regional organization of 21 member states - similarly committed to “rationalize and phase out over the medium-term inefficient fossil fuel subsidies that encourage wasteful consumption” (APEC 2015) in 2009. In 2010 an informal group of non-G20 countries was set up as “Friends of Fossil Fuel Subsidy Reform” (FFFSR 2021). In 2015 all countries committed to “rationalize inefficient fossil-fuel subsidies that encourage wasteful consumption by removing market distortions”(UN 2015) with the Sustainable Development Goal 12.c.1. The same year all countries agreed to limit “the increase in the global average temperature to well below 2°C” in the Paris Climate Agreement, which only can be achieved by limiting fossil fuels. In 2016 the G7 stated at the Ise-Shima Summit to “remain committed to the elimination of inefficient fossil fuel subsidies [...] by 2025”(G7 2016). In 2017 Vulnerable Twenty Group, the world’s most vulnerable economies called “for market distorting fossil fuel production subsidies to be removed immediately and no later than 2020” (V20 2017).

Despite all these promises, pledges and commitments, progress on cutting fossil fuel subsidies is slow and unsteady. The International Energy Agency (IEA) and the Organization for Economic Co-operation and Development (OECD) together estimate fossil fuel subsidies in 2019 at 467.7 billion USD. This decline from 576.9 billion USD in 2018 can be largely explained by the drop in global oil prices on consumption subsidies. The lack of systematic effort is also indicated by the longer trend stability of fossil fuel subsidies since 2010 when fossil fuel subsidies stood at 592.5 billion USD. Across 44 advanced and emerging economies fossil fuel production subsidies even rose by 38 per cent in 2019 (OECD & IEA 2020). Not even included in these numbers are COVID-19 recovery funds, which governments have spent since the beginning of the pandemic in December 2019. In addition, fossil fuels receive higher amounts of subsidies than renewable energy sources.



According to the Energy Policy Tracker, more than half of recovery funds committed to energy in G20 countries target fossil fuels. G20 countries spent again 293.10 billion USD in fossil fuel energy which surpasses the support given to clean energy amounting to 246.06 billion USD (IISD 2021).

## 2c) OBSTACLES TO MOVE FORWARD

To move further with a fossil fuel subsidies reform, several obstacles need to be addressed internationally. These include (a) agreeing on a common definition of fossil fuel subsidies and a standardized way of measuring fossil fuel subsidies, (b) incorporating the progress made in informal international groupings into the multilateral framework and (c) upgrading voluntary commitments over the long run.

### ***The Definition and Measurement Issue***

There is no internationally agreed definition of fossil fuel subsidies. Three different international organizations, the OECD, the IEA and the IMF apply different conceptualizations of fossil fuel subsidies based on inventor, price gap, and price gap including negative externalities (Hayer 2017). The specifications of 'efficient' or 'inefficient' fossil fuel subsidies referring to market distortions do not seem to add clarity. The different conceptualizations of fossil fuel subsidies lead downstream to vastly different estimations of the scales of fossil fuel subsidies and actors involved ranging for example in 2015 to estimates from approximately 550 billion USD (IEA 2014) to 5300 billion USD (Coady et al. 2015). If one follows the IMF approach the largest subsidizers were China (1.4 trillion USD), USA (649 billion), Russia (551 billion), the EU (289 billion), and India (209 billion) (Coady et al. 2019). If one adapts the IEA approach the largest subsidizers are Iran, China, Saudi Arabia, Russia and India (IEA 2019). Depending on the definition and method, different political implications follow which explains the continuing debate on the issue and poses problems in terms of monitoring and enforcing existing commitments (Bárány & Grigonytė 2015, Kojina & Koplov 2015, Skovgaard 2017, Timperley 2017, IISD & UNEP 2019). Instead of blaming

one method to be false (Lomborg 2020), states should agree on a common definition and measurement standards.

### ***The Multilateralization Issue***

Many different international organizations like the World Bank, the IMF, the OECD, the IEA, the UNEP, the UNFCCC, the WTO, and informal groupings like the G7 and the G20 engaged in the discussion on a fossil fuel subsidies reform. While this multiplicity of actors reflects the cross-cutting nature and implications of fossil fuel subsidies, this regime complexity (Alter & Meunier 2009) confers on actors the space for discourse fragmentation, forum shopping, and regime shifting behaviour rather than substantially moving forward with fossil fuel subsidies reform. In 2017, for example, when the G20 discussed broadening the G7 announcement from 2016 to phase out fossil subsidies by 2025, the 20 most climate vulnerable countries called the G20 to phase out fossil fuel subsidies and a group of 15 countries launched a ministerial statement on fossil fuel subsidies within the WTO. This example shows that due to the varying degrees of environmental, economic, and social impacts of fossil fuel subsidies on countries, there is a need for an inclusive format where different groups of states can participate and voice their perspectives.

### ***The Voluntariness Issue***

Within the OECD and the APEC framework single states have committed to voluntary self-reporting and peer reviews. In December 2013, the USA and China announced to undertake reciprocal peer reviews of their fossil fuel subsidies under the G20 process supervised by the OECD – an initiative to which Germany, Mexico, Indonesia, and Italy joined. Similar peer reviews have started under APEC as well, with Peru, New Zealand, the Philippines, Chinese Taipei, Viet Nam, and Brunei Darussalam participating. While these voluntary reviews provided a good start to move the process on fossil fuel subsidies further, they lack common criteria, clear phase-out dates, and follow-up mechanisms (OECD 2016). In the long term, these voluntary reviews should be institutionalized in a framework which allows a higher degree of predictability, commitment, and bindingness of voluntary commitments.

### 3. FOSSIL FUEL SUBSIDIES AND THE WTO

#### 3a) THE POTENTIAL OF THE WTO

The WTO has high potential to move forward an international fossil fuel subsidies reform. This potential roots in the unique capacities of the WTO on subsidy regulation, the current search for a restart of the WTO and existing building blocks on fossil fuel subsidies within the WTO framework.

The WTO provides unique institutional and technical capacities in regard to fossil fuel subsidies. Considering the definition of fossil fuel subsidies, the only internationally agreed definition of the term subsidies, which all different conceptualizations of fossil fuel subsidies take as starting point, stems from the WTO Agreement on Subsidies and Countervailing Measures (1994). Building up on this early agreement and the technical expertise of the WTO in handling trade-distorting subsidies of all kinds, the WTO framework seems to be the right venue to move forward discussions on an internationally agreed standard of fossil fuel subsidies measures. In addition, the WTO brings an institutionalized framework with binding rules and experience in disciplining states on subsidies (Verkuijl et al. 2019). The broad membership of countries within the WTO is another institutional advantage. 164 countries are WTO members, and several others like Iran, which is important for international fossil fuel subsidies efforts, have observer status. This broad membership provides not only the necessary participation options for different groupings of countries. It also avoids free rider problems with regard to the international competitiveness disadvantages for domestic industries by unilaterally phasing out fossil fuels subsidies.

The WTO is currently searching for a fresh restart. This is not only due to the current blockade of its dispute settlement mechanism, but also related to other structural problems like the never finished Doha Negotiation Round. The election of Ngozi Okonjo-Iweala as seventh Director-General in March 2021 - the first African woman ever elected in this position, is a sign of political will of Member States for such a restart. A fossil fuel subsidy reform might be the success story the WTO needs at the moment, because it meets the longstanding

scepticism towards the organization's commitment to sustainable development beyond growth and to environmental protection. The restart of the WTO could thus be seen as window of opportunity for the WTO to reboot in regard to environmental protection and complement the unfinished business of the environmental chapter of the Doha Declaration. In addition, it would accommodate the new US president Joe Biden's election promise to "ban fossil fuel subsidies" globally, which could be one element to solve the US blockage of the dispute settlement mechanism.

Fossil fuel subsidies reforms within the WTO do not need to start from scratch. It can build upon and expand the 2017 Ministerial Declaration on Fossil Fuel Subsidy Reform, seeking "the rationalisation and phase out of inefficient fossil fuel subsidies" (WTO 2017), which was initiated by a diverse group of 14 countries. Moreover, a group of 25 parties including the European Union called in November 2020 to "address and promote dialogue and information sharing at the WTO on issues where trade and environment policy intersect including [...] fossil fuel subsidies" (WTO 2020). Eventually, New Zealand proposed in February 2021 to include Fossil Fuel Subsidies Reform as an element of the Trade and Environmental Sustainability Structured Discussions (WTO 2021).

### 3b) CHALLENGES UNDER THE WTO

Despite these institutional advantages of and already existing building stones within the WTO, there are also several challenges for a fossil fuel subsidy reform under the current WTO framework (Van Asselt & Irschlinger 2020, Van Asselt & Moerenhout 2020). In particular, moving forward with a fossil fuel reform within the WTO requires taking into account the current legal and institutional framework of the WTO.

#### ***Current mechanism on Subsidies***

The WTO's Agreement on Subsidies and Countervailing Measures (ASCM) is the WTO's main instrument disciplining energy subsidies. However, the ASCM as it currently stands is not suitable to deliver the objective of phasing out fossil fuel subsidies. Procedurally, the ASCM poses a high threshold before a Member State can successfully challenge a fossil fuel

subsidy. The difficulties in overcoming this hurdle can deter governments from challenging fossil fuel subsidies to begin with (Verkuij et al. 2019). Furthermore, substantively, the ASCM does not aim to discipline all types of subsidies but only those that have negative cross-border trade impacts within the meaning of “actionable” and “prohibited” subsidies under the ASCM.

### ***Procedural Hurdles***

From a procedural perspective, a Member State party must meet a relatively high evidentiary threshold in order to challenge fossil fuel subsidies and avail of remedies under the ASCM. This entails satisfying cumulative conditions to establish the existence of a subsidy and that the subsidy either qualifies as an actionable or prohibited subsidy under the ASCM. Under the ASCM, a subsidy exists where a government provides a form of financial contribution (or a form of income or price support) and thereby confers a benefit to its recipient (ASCM, Art.1). In order to be subject to the ASCM disciplines, however, it is crucial that such subsidy is shown to be specific (ASCM, Art. 8) in that it benefits particular enterprise(s) or industry(ies) (ASCM, Art. 2). Non-specific subsidies cannot be challenged under the ASCM (Coppens 2014). Whereas prohibited subsidies are presumed to be specific, the specificity of actionable subsidies needs to be “clearly substantiated on the basis of positive evidence” (ASCM, Art. 2.4). Relevantly, the specificity requirement may be more difficult to establish in case of fossil fuel subsidies granted to consumers instead of producers directly (Asmelash 2015). The complainant may have to establish *de facto* specificity, i.e. that the consumer subsidies disproportionately benefited energy-intensive industries in order to meet the specificity requirement (Asmelash 2015; Verkuijl et al. 2019). The fact that fossil fuel subsidies are predominantly provided in the form of consumer subsidies (OECD 2021) indicate the magnitude of the probable under-capture of these subsidies under the ASCM (Asmelash 2015; Verkuijl et al. 2019).

To give rise to remedies, fossil fuel subsidies must also be shown to satisfy the conditions of actionable or prohibited subsidies. Actionable subsidies require the complainant to establish adverse effects to the interests of other WTO members within the parameters

described under Art. 5 of the ASCM. Discharging this burden of proof can be arduous and expensive (Wold 2012; Verkuijl 2020). On the other hand, prohibited subsidies as defined under Art. 3 of the ASCM are confined to those that are contingent on export performance or use of local content requirements. Relevantly, fossil fuel exports are rarely subsidised (Asmelash 2015) and neither do fossil fuel subsidies use “local content requirements”, which take them out from the ambit of prohibited subsidies (Verkuijl 2020).

### ***Reconciling Economic, Environmental and Societal Objectives***

The ASCM focuses on trade-distortions and disregards any negative effects of subsidies on the environment (Moerenhout & Irschlinger, 2020). Substantively, subsidies that can be successfully challenged under the ASCM are only those that have negative trade impacts (those that have adverse effects on other WTO members or presumed to be trade distorting). This means that those subsidies that do not have the same effects can be maintained. Yet, from an environmental perspective, this distinction is irrelevant insofar as fossil fuel subsidies serve to perpetuate emission-intensive industries regardless of their trade impacts on other countries. Protecting subsidies that are neither actionable nor prohibited upholds the pre-eminence of economic over environmental aims. This result is arguably incoherent with the sustainable development principles enshrined within the WTO Agreement itself. Consequently, from an environmental perspective, the reforms need to go beyond the current scope of what is being disciplined under the ASCM insofar as fossil fuel subsidies are concerned. A new agreement on fossil fuel subsidies provides an opportunity to realign environment and trade objectives within the WTO.

At the same time, however, there is a need to ensure that the fossil fuel reform will not disproportionately impact societies with limited access to energy. Thus, the path forward should incorporate social safety nets to ensure a just transition, while ensuring that efforts to improve access to energy means access to “clean” energy. This is necessary if such a reform is to obtain domestic political support from affected WTO member countries.



### ***Institutional Challenges***

Eliminating fossil fuel subsidies will entail creating far-reaching obligations on WTO member states. The choice of how to reach an agreement on these new obligations will inevitably influence the pace and level of ambition of the reforms. Opting to implement the reforms by amending the ASCM (e.g. by broadening the definition of prohibited subsidies to include fossil fuel subsidies (Das et al. 2019)) requires complying with the two-step amendment procedure set out under Art. XX of the WTO Agreement. First, the WTO's Ministerial Conference needs to decide by consensus whether to submit a proposed amendment to the Members for acceptance. The proposed amendments will then only take effect upon acceptance by at least two-thirds of the members of the WTO vis-à-vis those members who have accepted such amendments. This vote requirement can significantly delay the adoption while risking an extensively negotiated "amendment" with diluted commitments.

The reforms can also be implemented via a plurilateral agreement to set out a separate regime for fossil fuel subsidies, similar to the ongoing fisheries subsidies negotiations. Such a plurilateral agreement may be exclusive (where only the parties to such an agreement benefit from the trade concessions), or inclusive (benefits are extended even to WTO members who are non-parties to the trade agreement) (Das et al. 2019). At any rate, the Ministerial Conference needs to decide by consensus on whether to add a trade agreement as part of Annex 4 on plurilateral agreements. In any of these options, consensus building and political support is crucial.

## **4) PATH FORWARD**

In order to address the climate change challenge, reforms on fossil fuel subsidies within the WTO should thus be ambitious in its scope while carefully carving out exceptions to protect low-income households and communities where no suitable alternative energy is available. Tackling the reforms within the WTO should combine immediate action with a long-term sustainable vision. This would require WTO to augment existing mechanisms to improve monitoring and disciplining of fossil fuel subsidies, providing the groundwork

for the adoption of an ambitious fossil fuels regime in the mid-to-long term. The latter will naturally demand a baseline of political will. Consequently, the choice of the institutional solution should be well suited to allow for an ambitious reform while minimizing negative interference from political constraints. Key elements of such a reform are proposed below.

#### 4a) HARNESSING THE LOW-HANGING FRUITS: UTILIZING EXISTING WTO MECHANISMS TO INCREASE TRANSPARENCY

Although utilizing mechanisms that already exist under the WTO framework limits the ability to drastically alter the status quo, it can still be a viable tool to achieve considerable progress with significantly less effort. The available tools facilitating transparency within the WTO may be fine-tuned to the extent possible in order to reach efficient outcomes regarding clarity and visibility of fossil fuel subsidies.

Members do not notify fossil fuel subsidies as much as they should under the ASCM, which limits the usefulness of the SCM Committee. Increased transparency can help build political pressure from other WTO member states, but also from civil society organizations. One avenue through which the latter can be achieved is agreeing on a baseline list of measures that should be notified in the regular Trade Policy Review Meetings (TPRM) of the WTO (van Asselt & Irschlinger, 2020). The existing TPRM mechanism would take the current WTO definition of a subsidy under the ASCM but clarify it further so as to delineate what types of governmental support are to be regarded as high priority from a notification perspective. In this way, Members can agree on clarifications that highlight which measures are to be regarded as “reporting-worthy”. For instance, reporting the activities of state-owned enterprises operating in the energy sector can yield significant benefits for the tracking of fossil fuel subsidies as the activities of SOEs are often marked by their opacity. This focus can increase both the quantity and quality of notification and reporting as clear rules to which Members are expected to adhere will boost clarity and assist in improving peer oversight. By increasing the specificity of measures that need to be notified, civic organizations can also focus their efforts and make targeted demands for accountability

from their governments. This can play an important role in counterbalancing the political clout that many beneficiaries of producer subsidies enjoy. SOEs in the energy sector alone often pose significant hurdles in implementing reforms as they have the organizational and financial resources to resist efforts in strengthening governance (Hayer et al. 2017). Similarly, determining that the provision of public finances to undertakings for them to carry out fossil fuel-related operations are to be notified may also prove valuable.

The Trade Policy Review Body could also instruct that all WTO Secretariat TPRM reports include a dedicated section on fossil fuel subsidies, including the areas highlighted above, and could extend this to include other energy subsidies and more information on fossil fuels in general (i.e. the rationale for the government intervention, the value of trade of fossil fuels, the emissions of greenhouse gases from their combustion). This builds on the voluntary peer review process already being implemented by the G20. Capitalising on reporting and subsequent peer-reviews in this manner is capable of yielding valuable returns. For example, as the International Energy Association (IEA) suggests, the reporting of fossil fuel subsidies attracts attention to countries' support policies and the way in which they are implemented. Moreover, taking part in monitoring activities may support countries in "learning by doing" as the TPRM would double as a venue in which the measures at stake can be readily discussed. Making the underlying rationale of government support measures visible, such as which market externalities are sought to be corrected by them and their intended beneficiaries, bring to fore the possibility of exploring more environmentally sustainable, cost-efficient and effective alternatives that may have been undertaken in other member countries (OECD 2020). Lastly, the procedure can greatly assist in detecting, discussing, and alleviating problems related to, the interpretation of contentious concepts, such as "inefficient subsidy", or other terms introduced above (IEA & OECD 2018). Such an engagement would support formulating reforms that would decrease the harm inflicted on poorer households via the retraction of existing subsidies while discouraging Members from granting blanket subsidies to an entire sector or industry.

## 4b) CREATING A NEW REGIME: TOWARDS A BINDING STANDALONE MULTILATERAL AGREEMENT ON FOSSIL FUEL SUBSIDIES

In the mid-to-long term, a more ambitious fossil fuels subsidies regime under the WTO should be based on the general principle that fossil fuel subsidies are to be prohibited, unless justified by a limited and well-defined list of legitimate public policy objectives, such as access to energy. This prohibition can be operationalized through commitments on a standstill obligation, the elimination of producer subsidies, the gradual phase out of justified consumer subsidies, and adoption of transitional arrangements.

### ***Standstill obligation***

The new regime should establish a standstill obligation on the adoption of new subsidy measures. Creating new capacity through providing subsidies to energy producers utilising fossil fuels would inherently contravene the goals of the Paris Agreement (Cui et al. 2019). Establishing a standstill obligation overcomes the legal difficulty of challenging fossil fuel subsidies under the ASCM by prohibiting them without needing to prove adverse trade impacts.

Relevantly, imposing standstill obligations on subsidies is not new to the global trading regime. A similar provision is currently in force between some of the largest economies of the world. Article 24.20 of the United States - Mexico - Canada Agreement (“USMCA”) prohibits the parties from *granting* or maintaining certain forms of environmentally-harmful fisheries subsidies. They are also largely coherent with the latest Communication from the European Commission on EU trade policy, which states that the EU will “discourage all further investments into fossil-fuel based energy infrastructure projects” (European Commission 2021). Creating a stand-still obligation on fossil fuel subsidies would create a coherent environment at the WTO, which is also pursuing efforts to subdue environmentally-harmful fisheries subsidies. This could bring together related policies and generate efficiencies through which knowledge accumulated in one area can be extrapolated to the other to the extent possible.

### ***Eliminate Producer Subsidies***

Current government policies tackling environmental impacts of fossil fuels have focused on targeting emissions and fuel use, rather than restricting fossil fuel supply (OECD 2021). A fossil fuel subsidies reform should however seek to eliminate existing producer subsidies to reduce fossil-fuel dependency.

Producer subsidies are often opaque and difficult to measure. They involve a wide range of government measures including direct or potential direct transfers, revenue foregone, government provision of services and goods, direct income or price support. As a starting point, reforms could focus on government programs that are the easiest to identify. In this regard, the OECD noted that direct spending programs and tax expenditures are the ones relatively easiest to identify as they are often well documented, reflected in the budget cycles and subjected to executive and legislative scrutiny (OECD 2021). These types of measures are also relevant in terms of scale. OECD's inventory of support measures for fossil fuels revealed the prevalence of tax expenditures as a form of providing preferential treatment towards the production of fossil fuels among OECD and G20 economies (Elgouacem 2020). The 2019 G20 peer-review of inefficient fossil fuel subsidies (involving 6 members) also confirmed that preferential tax provisions in favor of upstream oil and gas projects are the prevalent forms of subsidies in the production side (OECD-IEA 2019). Within these cluster of measures, further analysis can be undertaken to specify support mechanisms that have the most important implications in terms of improving environmental performance and economic efficiency. Lessons learned from the TPRM mechanism can feed into this process to help focus the negotiations or commitments in respect of eliminating the most environmentally impactful producer subsidies.

### ***Phase out of Consumer Subsidies and Transitional Arrangements***

There is a need for a more nuanced approach when dealing with consumer subsidies. Notably, consumer subsidies constitute the bulk of fossil fuel subsidies and tend to benefit high income households more. There are thus economic, environment and social

justifications to remove consumer subsidies at large. However, removal of consumer subsidies can have disproportionate impacts on disadvantaged households. Removal of fossil fuel subsidies can increase their price. If there are alternatives available, such as renewable or nuclear energy, there is a possibility for consumers to switch to renewable sources to accommodate their energy needs in the face of a fossil fuel price surge. However, renewable energy is still scarce in many parts of the world. Currently 26.2% of the global electricity production is being supplied by renewable sources, with the share significantly lower for developing countries (REN21 2019). Without an alternative source, a significant price increase brought about by the removal of consumer fossil fuel subsidies would not induce commensurate levels of reduction in fossil-fuel use, but instead damage poorer households. In Mexico, for example, the IEA reported that consumer subsidies reforms were not successful in reducing the demand for fossil fuels in the absence of affordable alternatives (IEA 2016). Thus, the new agreement should allow for a more gradual phase out of consumer subsidies, in particular in developing countries. This is to provide a transitional period for affected countries to build the necessary infrastructure for alternative energy. Enabling such a transition would also require exploring or clarifying under the new FFS agreement to what extent subsidies for renewable energy should be allowed.

At the same time, consumer subsidies should only be allowed if narrowly designed to limit the benefit to the group in need of financial support to minimize inefficiency. Consumer subsidies should be substantiated by an evidenced-based assessment of impacts of subsidy reforms on disadvantaged households. As such an assessment needs data and technical capacity (Beaton et al. 2013), the new agreement should ensure that the development of well-targeted consumption subsidies should be included within WTO's trade-related technical assistance activities. The TPRM reporting should also help identify commensurate policies that can mitigate the adverse effects of subsidy reforms on vulnerable groups and sectors.



### ***Procedural Aspects: Consensus building towards a binding multilateral agreement***

Even though fossil fuel subsidy reform has been discussed at the WTO for quite some time, the task of creating a new multilateral agreement is likely to be arduous. As argued above, we propose to introduce measures that entail substantial duties on Members, such as the standstill obligation and the phasing out of producer subsidies. There are multiple routes that can be taken to reach this destination, however, for the reasons enumerated below, we believe that adopting a joint statement route, as a first step, can yield the most fruitful results in a relatively short time-frame.

Achieving a political support base for the construction of a new measure necessitates consensus building. In that regard, lessons learned from the endeavours to reform another, related strand of WTO policy can confer valuable insights: fisheries subsidies. Indeed, consensus building for the negotiation of even joint statements can take substantial amounts of time as the latter will consequently lead to binding multilateral agreements later on. Secondly, the broader the range of participating members, the more interests are on the table that have to be traded off in order to reach a compromise. Considering the number of profiles different members boast, it is safe to assume that this will apply to our proposal to reform fossil fuel subsidies, similarly to what is currently going on at the WTO as regards fisheries reform (Parmentier 2021). Lastly, even questions of collective action that would benefit everyone in the long run come down, in the short run, to a tough negotiation of how much different countries are willing to contribute to the objectives of an agreement.

Keeping in mind the foregoing assessments, a joint statement route is proposed as a starting point for a possible plurilateral, and eventually a multilateral agreement. A bottom-up approach whereby a group of like-minded countries start the processes for legal reform has been the dominant approach since the inception of the multilateral trading system. A voluntary joint statement can help build further political momentum, set high standards, and facilitate experimentation that can be the basis for binding commitments later on. This route allows for ambitious steps to be taken within a shorter period of time compared to the arduous process involved in amending the ASCM, making it a more suitable response

given the urgent climate change challenge. Importantly, this also provides the platform to agree and elaborate on the definition of fossil fuel subsidies to facilitate the identification and monitoring of these measures, which can become binding against WTO member states in the future.

To have significant political and environmental impact, the joint statement should be signed by the G20 members building on their fossil fuel subsidies commitments during the Pittsburgh Summit and can include signatories to the Friends of Fossil Fuel Subsidy Reform and other similar coalitions. The International Monetary Fund reported in 2019 that China, United States, Russia, the EU, and India provided the largest subsidies in 2015 (Coady et al. 2019). Yet, most of the latter countries have recently confirmed ambitious commitments against fossil fuel subsidies. Both the European Green Deal and the US Made in America Tax Plan (2021) communicated clear support to end fossil fuel subsidies. Russia and China made the same commitment as G20 (G20 2009) and APEC (APEC 2009) members, with China aiming for climate neutrality by 2060 (Heggelund 2021). China also submitted to the G20 peer-review process on inefficient fossil fuels (OECD-IEA 2019). These developments signal political momentum to support a much-needed ambitious initiative to phase out fossil fuel subsidies. At the same time, creating the safeguards and transitional arrangements to ensure access to energy should help facilitate political support from developing countries.

## 5) CONCLUSION

To limit global temperature increases to below 2°C, governments need to phase out fossil fuel subsidies. The fact that different governments are expressing political commitments to support such an endeavor is promising. In order to facilitate results and avoid freeriding, these aspirations need to be operationalized into concrete commitments within a framework that allows for monitoring and enforcement. Significantly, the WTO has the wide membership, technical expertise and organizational capacity, which can be leveraged upon to forge a new global agreement on fossil fuel subsidies. The path forward then consists

of using and augmenting existing WTO mechanisms, such as the TPRM, to better monitor and curb the use of fossil fuel subsidies under the current ASCM as a short-term solution. Besides increasing transparency, the TPRM mechanism can also be used to facilitate discussions on narrowing the scope of subsidies while mitigating impacts on vulnerable groups and sectors. This should already allow for a gradual transformation of the industry, making it possible for governments to reach a new and ambitious agreement to phase out fossil fuel subsidies in the mid-to-long term.

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***The access to all online references was checked on July 31, 2021.***

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HOW TO REIN IN FOSSIL FUEL SUBSIDIES?  
TOWARDS A NEW WTO REGIME

October 2021  
Brussels School of Governance,  
Brussels, Belgium



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