

THE POLITICS OF FOSSIL FUEL SUBSIDIES AND THEIR REFORM

Fossil fuel subsidies strain public budgets and contribute to climate change and local air pollution. Despite widespread agreement among experts about the benefits of reforming fossil fuel subsidies, repeated international commitments to eliminate them, and valiant efforts by some countries to reform them, they continue to persist. This book helps explain this conundrum by exploring the politics of fossil fuel subsidies and their reform. Bringing together scholars and practitioners, the book offers new case studies both from countries that have undertaken subsidy reform and from those which have yet to do so. It explores the roles of various inter-governmental and non-governmental institutions in promoting fossil fuel subsidy reform at the international level, as well as conceptual aspects of fossil fuel subsidies. This is essential reading for researchers and practitioners and students of political science, international relations, law, public policy and environmental studies. This title is also available as Open Access.

JAKOB SKOVGAARD is Associate Professor in the Department of Political Science at Lund University (Sweden), undertaking research on EU and international climate change policy. From 2007 to 2010 he worked on the international climate change team of the Danish Finance Ministry, his responsibilities covering, inter alia, international fossil fuel subsidy reform. His recent publications include articles in *Global Environmental Politics*, *Journal of Common Market Studies*, *World Development and Environmental Politics* and a special issue of *International Environmental Agreements: Politics, Law and Economics*.

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“Fossil fuel subsidies are enormous, damaging, and fiendishly hard to reform. This is an essential, comprehensive guide to understanding the issue – and identifying the narrow pathways that may lead to reform. Anyone concerned with the political economy of climate change will benefit from Skovgaard and van Asselt’s important book.”

– *Michael L. Ross, University of California, Los Angeles*

“Fossil fuel subsidies are expensive and harmful to the environment, yet governments around the world continue to dole them out. This volume offers a comprehensive review of the problem, the politics surrounding it, and experiences with reform efforts in different countries. Skovgaard and van Asselt have compiled an excellent collection on one of the great public policy problems of our time.”

– *Johannes Urpelainen, Johns Hopkins University*

“Over the past century, the politics, institutions and infrastructure of industrial economies have co-evolved with fossil fuels. Yet, addressing climate change is impossible if countries do not wean themselves off fossil fuels, and fast. In this comprehensive new book, Skovgaard and van Asselt, along with a diverse set of contributors, unpack the entrenched politics of fossil fuel subsidies that lie at the heart of this dilemma. Built both around detailed country cases and the dynamics of international institutional politics, they develop a framework to understand the emergence of fossil fuel subsidies as a key agenda in global and national climate politics, but also for its uncertain progress. In both its wide scope, as well as its incisive treatment, this is a field-defining volume of a critical topic.”

– *Navroz K. Dubash, Centre for Policy Research, New Delhi*

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To two special people, Franka and Aeryn. May they live
to see a fossil-free future.

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Foreword

At the risk of stating the obvious, it is clear that the world has not become a simpler place since Francis Fukuyama declared the end of history in 1989 (Fukuyama 1989). We are now in an era of increasing complexity, characterised by a potential unravelling of existing certainties. These certainties appeared for a time at least to include continued public support for globalisation in general and multilateralism in particular.

In terms of the specific subject of this book, the past decade has seen growing international interest in the reform of fossil fuel subsidies. This has manifested in high-flown rhetoric from G20 and Asia-Pacific Economic Cooperation (APEC) leaders, in groundbreaking work by the Organisation for Economic Co-operation and Development (OECD) and the International Energy Agency (IEA) and in the tentative steps taken by some particularly committed countries to advance the issue at the World Trade Organization (WTO). Underpinning all of this has been the far-sighted engagement on this issue by non-governmental organisations. First among equals in this space has been the Global Subsidies Initiative of the International Institute for Sustainable Development. Their work and their reputation for rigour and quality have made serious inroads into the political resistance to reform. Additional and valued support has come from the World Economic Forum's partnership with the International Centre for Trade and Sustainable Development, which, together with the Global Subsidies Initiative, has sought to explore the options for domestic and international reform in this space.

It is not difficult to understand the urgency of the challenge. In terms of the economics, the sheer scale of taxpayer support for fossil fuels is eye-popping. The IEA, for instance, has estimated that consumer subsidies alone are worth nearly half a trillion dollars per annum. Put differently, this is the equivalent of four times the level of OECD members' official development assistance. Subsidies to the fossil fuel industry are also distorting domestic policymaking. Some countries, for instance, are spending more per annum on such subsidies than on

healthcare or education. This is a situation that is clearly unsustainable in fiscal terms, let alone on the grounds of equity and human development.

The environmental benefit from reform is similarly clear. Global warming is widely understood to present an existential challenge. By some estimates, eliminating fossil fuel subsidies would decrease greenhouse gas emissions by up to 13 per cent by 2050 (Merrill et al. 2014). This is rather more than a clutch of countries can contribute, even if they stopped all emissions overnight. More particularly, ensuring that the externalities of fossil fuels (i.e. costs to society from air pollution and so on) are priced through the tax system could reduce carbon emissions by nearly 25 per cent (Parry et al. 2014). And thanks to the work of the OECD and the IEA, we know a great deal more about where and how subsidies are spent, including by whom. This groundbreaking work in the form of a time-series data set is proving invaluable for reformers.

The emergence of this kind of striking data has been complemented by rhetorical commitments to reform by G20 and APEC leaders. These statements suggest that there is a collective will to reform, at least over the medium term. At the same time, initiatives by non-G20 members, such as the Friends of Fossil Fuel Subsidy Reform – including Costa Rica, Denmark, Ethiopia, Finland, Sweden, Switzerland, New Zealand, Norway and Uruguay – were established to encourage the G20 and others to advance reform ambitiously and transparently. In 2015, further momentum was generated through another set of leader-level commitments enshrined in the United Nations' Sustainable Development Goals (SDGs). There was a growing assumption therefore in many countries that reform – meaningful reform – may be just around the corner.

Unfortunately, it appears that those easy – and perhaps in hindsight complacent – assumptions are misplaced. The politics of reform has simply proved too hard, at least at the international level, and the way ahead is unclear at best.

In fact, the challenge has sharpened. Oil prices continue to fluctuate, and there appears to be a growing expectation that globally there will be a realignment of thinking about fossil fuels and the impact they have on climate change. On the one hand, this may create the conditions for real reform. On the other hand, we need to be alert to what German economist Hans-Werner Sinn (2012) famously called the 'green paradox': the policy signal that fossil fuel use might be constrained in the future, including through the reform and elimination of subsidies, may provide a perverse incentive to fossil fuel producers to produce as much as they can while the going is good. There are certainly indications that this is precisely what has driven some of the recent expansion of oil production over the past three years.

But all is not lost. As this important book reveals, reform is not only desirable but also achievable. It can be secured through deft engagement and focus at the

regional and domestic levels. There is scope, too, for work multilaterally at various levels of ambition, as this book underscores.

In this regard, it is a truism that a robust and fair multilateral trading system hinges on coherence between domestic and international economic policy. The SDGs in this context need to be understood for what they are: not an irritating distraction from the so-called real work of trade negotiations, but an expression of public concern about global issues and challenges. They represent an opportunity to demonstrate to an increasingly sceptical international and domestic polity that the trade policy community can contribute to solutions. In other words, trade really does matter. International economic policy coherence remains a key value proposition and an enduring theme for this book. Set in the context of an emerging set of global and transboundary environmental challenges that pose profound economic and human development risks, policy coherence brings together the elements that will drive effective change policies.

Of particular interest to me as a trade negotiator has been how one might deploy trade disciplines to drive reform. After all, the WTO is the only international institution that has a dispute settlement mechanism with real teeth. Importantly, too, in these uncertain times, it is the only place where all the major economies are legally bound to certain commitments and disciplines. Expanding such disciplines to include fossil fuel subsidy reform seems like a no-brainer.

This book shows that we can and should do more to reinforce coherence and sustain public confidence in the benefits of trade disciplines. In this regard, the possible relationship between trade disciplines and fossil fuel subsidies is an area for active consideration and future negotiation. After all, as this book demonstrates, trade disciplines can correct distortions in global trade, help mitigate climate change, deliver development benefits and simultaneously assist countries in achieving SDG12 (ensuring sustainable consumption and production patterns). What's not to like about this kind of win-win-win-win solution? In any case, there is no escaping a sharp-edged question to policymakers: if trade is not part of the solution, how precisely will countries deliver on their leaders' commitments enunciated in the SDGs?

What is clear is that there is an urgent challenge confronting us. If we can 'crack the code' of the political economy of fossil fuel subsidy reform, the benefits – economic and environmental, not to mention for trade and public confidence – will be significant. In the meantime, reform must proceed on multiple fronts through public pressure, intergovernmental negotiation and, complementing this, a push for new, effective and enforceable trade disciplines.

This book therefore is a measurable contribution to enhancing our understanding of the key political obstacles countries face in reform at the domestic, regional and international levels. It also suggests ways in which we can proceed to meaningful

reform. That this will be politically difficult and technically a challenge is evident, but as the book makes clear, it is one we must tackle – and urgently. To adapt and paraphrase Schumpeter’s description of the role of entrepreneurs and apply it in this context: it really is time for us to act ‘with confidence beyond the range of familiar beacons and overcome resistance which requires aptitudes and persistence’ (Schumpeter 1942: 132). In short, the message at the heart of this important contribution to our understanding of the politics of fossil fuel subsidy reform is one of determination and hope, but certainly not of complacent expectation.

Vangelis Vitalis

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Disclaimer

This contribution is provided in a personal capacity and does not necessarily represent the views of the New Zealand Ministry of Foreign Affairs and Trade.

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Preface

Fossil fuel subsidies, as well as efforts to reform them, have entered the mainstream political and societal debate following the G20 commitment to rationalise and phase out fossil fuel subsidies in 2009. Owing to the efforts of a range of inter-governmental and non-governmental organisations, including the Organisation for Economic Co-operation and Development, the International Energy Agency, the International Monetary Fund, the World Bank, the Global Subsidies Initiative, Oil Change International and the Overseas Development Institute, to name but a few, we now know much more about their size (which is by any measure very substantial), their use in practice in both developed and developing countries and their socio-economic and environmental effects. Likewise, our understanding of efforts to reform fossil fuel subsidies has increased significantly, with practical experiences pointing to lessons to emulate – or avoid.

Yet, while interest in the subject from policymakers and practitioners is clearly increasing, academic engagement is still in its infancy. For instance, as a crude indication, a search at the time of writing (September 2017) for ‘energy subsidies’, ‘energy subsidy’, ‘fossil fuel subsidies’ or ‘fossil fuel subsidy’ (and excluding ‘renewable’ energy subsidies) in the Web of Science yields only 55 academic articles, 43 of which were published after the G20 announcement. Moreover, many such studies to date are carried out by economists, with a view to modelling the economic and environmental impacts of fossil fuel subsidies (or of their reform). While we believe that such research remains crucial for furthering our understanding of the scope of the problem and the need for reform, we also believe that the *political* dimensions of fossil fuel subsidies and their reform have received insufficient scrutiny in the academic literature. Studying the political causes, consequences and normative implications of fossil fuel subsidies and their reform is indispensable for understanding why subsidies were created in the first place, why they persist and why it can be so difficult to reform them. Such analyses, in our view, can draw on decades of theoretical and empirical work in political science

and related social sciences that sheds light on international institutions and their influence on the domestic level, as well as political economy and policy change, output and processes. Through this book, we therefore hope not only to strengthen the body of knowledge on fossil fuel subsidies and their reform but also to bring together the empirical knowledge accumulated in the past years and longer-standing theoretical debates in political science and other social sciences.

Bridging the policy-oriented and academic communities was also a goal of the workshop that laid the foundation for this book. The workshop, held in Stockholm in June 2016, brought together seasoned experts on fossil fuel subsidies, representatives from non-governmental organisations, doctoral students and established scholars. The exchange of views, findings and experiences was extremely stimulating and showed that there is still much to learn from each other. We are thankful to all participants at the workshop for an inspiring discussion. To us, this book is the logical next step, and we hope that it offers a solid foundation for future exchanges and collaborations among scholars, students and practitioners as well as for future research.

The sum of an edited volume is only as good as its constituent parts, and we have been privileged to work with an excellent group of authors representing the various above-mentioned communities. We thank the authors for their patience, for their prompt responses to our seemingly never-ending queries and comments and, of course, for their valuable contributions.

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Leaving Fossil Fuels in the Ground'. The former project also funded the workshop in Stockholm, and both projects have enabled us to publish this book on an Open Access basis. Harro van Asselt has further been supported through the Stockholm Environment Institute's Initiative on Fossil Fuels and Climate Change (funded by the Swedish International Development Agency) as well as through the University of Eastern Finland.

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Abbreviations

ANC	African National Congress
APEC	Asia-Pacific Economic Cooperation
ASCM	Agreement on Subsidies and Countervailing Measures
CO ₂	carbon dioxide
COP	Colombian peso
CSE	consumer subsidy equivalent
DBTL	Direct Benefit Transfer scheme for LPG
DSM	dispute settlement mechanism (of the WTO)
EITI	Extractive Industries Transparency Initiative
EU	European Union
FARC	Revolutionary Armed Forces of Colombia
FFFSR	Friends of Fossil Fuel Subsidy Reform
FY	fiscal year
G7	Group of 7
G8	Group of 8
G20	Group of 20
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GSI	Global Subsidies Initiative
IDR	Indonesian rupiah
IEA	International Energy Agency
IGO	intergovernmental organisation
IMF	International Monetary Fund
INDC	intended nationally determined contribution
kWh	kilowatt hour
LCR	local content requirement
LDM	lead district manager

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LPG	liquefied petroleum gas
MoPNG	Ministry of Petroleum and Natural Gas (India)
NDC	nationally determined contribution
NGO	non-governmental organisation
OECD	Organisation for Economic Co-operation and Development
OMC	oil marketing company
OOC	other oil company
OPEC	Organization of Petroleum Exporting Countries
PSE	producer subsidy equivalent
RTA	regional trade agreement
SDG	Sustainable Development Goal
SBY	Susilo Bambang Yudhoyono
SOE	state-owned enterprise
TSE	total support estimate
UK	United Kingdom
UNEP	United Nations Environment Programme
UNFCCC	United Nations Framework Convention on Climate Change
US	United States
VAT	value-added tax
WTO	World Trade Organization