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POLICY BRIEF

FINANCING A FAIR ENERGY TRANSITION THROUGH FOSSIL FUEL SUBSIDY REFORM

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SUMMARY

In 2009, the G20 committed to gradually eliminating and streamlining subsidies for fossil fuels in the medium term. However, the global energy price crisis have driven subsidies to over USD 1 trillion worldwide for the first time in 2022.

It is essential to reform public support given to fossil fuels in order to create a level playing field for renewable energy and establish sustainable energy systems. Subsidy reform will protect consumers from unpredictable fossil fuel prices and allocate resources to other domestic priorities, as well as climate change mitigation and adaptation efforts.

To drive the implementation of subsidy reform commitments, G20 needs to reignite momentum. This brief recommends G20 governments to strengthen their commitment on fossil fuel subsidies and advance progress in fossil fuel subsidy reform.

THE CHALLENGE—REFORMING FOSSIL FUEL SUBSIDIES IS CRITICAL FOR CLIMATE

In 2009, the G20 members made a commitment to reform fossil fuel subsidies, aiming to gradually eliminate inefficient subsidies while providing targeted support to the poorest populations(G20, 2009). Since then, this commitment has been reiterated annually by the G20; and more recently, the United Nations Framework Convention on Climate Change (UNFCCC) Conference of Parties (COP) 26 and 27 (UNFCCC, 2022) also included similar commitments.

Government support, known as "public financial flows," plays a significant role in influencing private investment flows in the energy sector. This support includes subsidies and other forms of assistance, such as investments by state-owned enterprises (SOEs) and lending by public financial institutions. By redirecting support away from fossil fuels and towards clean energy, a strong market signal is sent to stimulate investment in low-carbon technologies and markets. This shift can also protect public institutions from becoming the last resort lenders for fossil assets and limit their exposure to the risks associated with stranded assets.

According to climate models, substantial emissions reductions are necessary to align with the goals of the Paris Agreement and effectively limit global warming to 1.5°C(IPCC, 2023). Urgent commitments are required to cease all new investments in fossil fuels and initiate a managed decline in fossil fuel production and consumption.

Despite Commitments—Subsidies are Increasing and Undermine Clean Energy

In 2021, G20 countries together provided USD 190 billion in fossil fuel subsidies, up from USD 147 billion in 2020(Climate Transparency, 2022). This surge was primarily driven by higher oil and gas prices, increased consumer support in Europe during the winter due to the Ukrainian conflict, and tax exemptions for certain state-owned enterprises dependent on fossil fuels. Globally, the International Energy Agency (IEA) estimates that fossil fuel consumption subsidies alone exceeded USD 1 trillion in 2022(IEA, 2023). Additionally, G20 governments offer various subsidies to reduce costs for fossil fuel producers, including tax breaks, dedicated public financing for production, and support to state-owned enterprises.

According to the scenarios outlined by the International Panel on Climate Change (IPCC), annual wind and solar PV technology investments currently amount to approximately USD 830 billion. To limit global warming to 1.5°C, an annual investment gap of USD 450 billion needs to be filled(Kursk et al., 2022). Redirecting fossil fuel subsidies alone would be more than enough to bridge this financing gap. Moreover, the removal of subsidies would alter market incentives, thereby influencing private investment flows towards cleaner energy sources.

Social Impacts Remain a Stumbling Block for Reform—But Subsidies Often Fail to Meet Social Welfare Objectives

In many emerging countries, fossil fuel subsidies have been implemented to ensure affordable energy access. The global energy price crisis has further exacerbated this trend, as several economies introduced subsidies to improve consumer affordability. However, there is a well-established consensus that such support for fossil fuels often fails to benefit the most vulnerable populations efficiently.

Consumer subsidies, which aim to lower energy prices for the general population, such as electricity, gasoline, kerosene, and liquid petroleum gas (LPG) for cooking, are susceptible to elite capture. A study examining fuel subsidies in 32 countries revealed that, on average, the top 20% of households receive at least six times more benefits than the bottom 20%(Coady et al., 2015). The wealthier the household, the more energy it can afford to purchase, resulting in greater subsidy benefits. Gasoline subsidies, in particular, were found to be highly regressive, with over 80% of the total subsidy benefits received by households in the top 40% of the population. Similarly, a survey conducted in 2019 on residential electricity subsidies in the Indian state of Jharkhand indicated that around 60% of the benefits went to the richest 40% of households(Sharma et al., 2020).

RECOMMENDATIONS TO THE G20

In 2023, the world needs to see the G20 show leadership in urgently implementing a shift in public financial flows away from fossil fuels and towards clean energy, as agreed in Paris Agreement Article 2.c.1, under the UNFCCC, and Sustainable Development Goal 12. Building on lessons from G20 members from the global South, where reforms are often seen to be most challenge, we encourage G20 governments to strengthen their commitment on fossil fuel subsidies, as follows:

1. **Redirect fossil fuel subsidy savings to social protection and clean energy**: G20 members should shift a share of savings from reform into improved social protection and increased public support for clean energy, reflecting the need for better non-subsidy mechanisms to support populations during energy- and living-price crises, and the urgent need to crowd in private investment for a rapid and socially responsible build-out of clean energy capacity by 2030.

2. **Account for all public financial support for fossil fuels.** The G20 should broaden their commitment on subsidies to more explicitly include all public support for fossil fuels, including state-owned enterprise investment and lending by public financial institutions. They should mandate state-owned institutions to establish strategies for contributing to net-zero targets, including shifting financial flows.

3. **Improve transparency:** G20 members should commit to annually report all support for fossil fuels under indicator SDG 12.c.1, in a comprehensive manner and on an annual basis, thereby leading by example and encouraging improved data transparency from all parties to the SDGs.

4. **Set a timeline for reform:** G20 members should adopt a specific timeline for fossil-fuel subsidy reform, bearing in mind the G7 goal to phase out fossil fuel subsidies by 2025, and the need to show leadership by fully implementing reform before 2030, the agreed data by all UN member countries under SDG 12.

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