

Key points

Rising prices, trade tensions, conflict and pressure on public budgets can make environmentally harmful subsidies (EHS) reform politically difficult. But these factors also reinforce the need for reforms that strengthen economic, social and environmental resilience.

Successful EHS reform requires coordinated government action, clear objectives and communication, and complementary programmes to help mitigate transition and long-term costs. Monitoring and evaluation can support the delivery of environmental and socioeconomic benefits.

Stakeholders including businesses, workers and their representative organisations, and producer and consumer groups should contribute to the design and implementation of EHS reform including shaping alternative incentives.

Repurposing EHS can redirect existing spending towards environmental and social priorities and improve fiscal sustainability through more efficient use of resources.

Reforming subsidies for socioeconomic and environmental resilience

Rising fuel prices, fluctuating harvests, trade tensions, conflict and shrinking fiscal space make environmentally harmful subsidies (EHS) reform politically and economically challenging, but the need to do so remains urgent. Governments can look beyond simply removing EHS and consider how existing public spending can be repurposed to reward sustainable businesses. We identify key characteristics of successful repurposing, including government coordination, clear communication, complementary programmes to support citizens, and monitoring of environmental and social impacts. We also highlight the role of businesses, workers, producer organisations and other non-government stakeholders in shaping and supporting effective, durable reform.

A challenging context for subsidies reform

Governments have made numerous commitments to achieve climate and nature goals but continue to spend over US\$2.4 trillion a year on environmentally harmful subsidies (EHS).¹ This includes subsidies to fossil fuels, agriculture, fisheries, water, transport, construction and plastics. These are usually intended to support domestic economic activity and correct market failures — but they also contribute to biodiversity loss, climate change and the unsustainable use of natural resources. Importantly, subsidies tend to be socially regressive, disproportionately benefiting wealthier households, and larger producers and businesses.² The impacts of subsidies can also move across borders, when wealthier nations subsidise activities that damage the environment and negatively impact local livelihoods in poorer nations, for example in the fisheries sector.³

Many governments have committed to reducing or reforming EHS through various international agreements. These include the Kunming-Montreal Global Biodiversity Framework (GBF) Target 18 that aims to reduce harmful spending by US\$500 billion annually by 2030, which would in turn represent most of the US\$700 billion nature finance target.⁴ There have also been sector-specific goals, such as the World Trade Organization Agreement on Fisheries Subsidies ratified in September 2025, and global efforts to build a roadmap for transitioning away from fossil fuels, as well as plurilateral agreements such as the Agreement on Climate Change, Trade and Sustainability.^{5–7} However, progress is slow, in part because EHS reform has real and perceived costs on households, workers and businesses. As a result, subsidies reform can be politically unpopular, and vested interests maintain the status quo. Simultaneously, fiscal, social and environmental sustainability benefits can take

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longer to realise and often are not actively measured, reducing the political appetite to engage in reform.

With rising fuel and food prices, trade tensions and shrinking fiscal space in many countries — and progressing climate and biodiversity crises — EHS reform is made both more difficult and more urgent. There is increased

pressure for energy security and calls from citizens for support with the cost of living. Yet periods of fiscal and economic pressure can also create opportunities. Is existing public expenditure delivering effective social, economic and environmental benefits? What policy changes could support new business development and economic diversification for countries that are fiscally constrained, even in times of geopolitical uncertainty?

More efficient government spending in times of fiscal constraint

Subsidy reform is not just an exercise in reducing public expenditure; it provides an opportunity to repurpose it for positive environmental and social incentives and government programmes, including those that can mitigate the short-term risks of reform. This distinction is essential because subsidies often exist for socioeconomic purposes, such as protecting and strengthening energy and food security, creating jobs and stimulating economic activity.² Governments are responsible for the regulatory framework that incentivises economic activity, and removing subsidies without considering how to support these underlying objectives can create real or perceived loss from a national to an individual level.

Identifying the most effective type of subsidy reform, design and implementation plan will depend on sector and national contexts and requires governments to first assess the existing subsidy framework, including objectives, target beneficiaries, and economic and environmental costs (Figure 1).

Successful reform and repurposing: common characteristics

Reforming EHS is a political and technical process that needs to consider macro and micro economic and political realities, as well as affected stakeholders, to be effective. This policy brief draws on six case studies from Colombia, Egypt, Indonesia, Mexico, Nigeria and the UK, as well as wider literature, to identify common characteristics of successful EHS reform. Successful reform can be defined as achieving the objectives of the reform (for example, fiscal sustainability, environmental outcomes) while minimising costs to vulnerable groups and political opposition. The longevity of reform is also a measure of success — particularly amid geopolitical tension — as it indicates social and political acceptability.⁹

Government coordination, cohesion and clarity

Subsidies are often managed by different government ministries or agencies, and their positive and negative impacts are cross sectoral. Therefore, intergovernmental coordination is essential for effective reform. From a technical perspective, coordination brings relevant expertise from across ministries to address interlinked challenges and objectives around fiscal sustainability, environmental impacts and social welfare. Agricultural subsidy reform in the UK is an example of cross-ministry coordination

Figure 1. Multiple scenarios to reform environmentally harmful subsidies⁸

Greening of subsidies	Reducing the value of subsidies	Eliminating subsidies	Modifying the most harmful elements of subsidies
The payment structure of a subsidy is retained but adjustments to the purpose, conditions, regulations and incentive structure are made, including turning subsidies into positive or neutral incentives.	The budget allocation for subsidies is reduced, which can increase fiscal space while lessening the impacts on nature.	Subsidies are either completely cancelled or gradually reduced over a number of years. This is advisable only after detailed analysis of the socio-economic and environmental impacts has been conducted.	The subsidies that incentivise the most damage are removed, without major overhaul of the subsidy.

between devolved administrations in England, Wales, Scotland and Northern Ireland. While each nation undertook a different repurposing programme tailored to its emission and nature targets, the financial envelope was set by the UK Treasury, enabling tailored support to varying types of agriculture across countries.

Ministries may have different priorities, and trade-offs may be necessary. Coordination is vital to ensure reforms are not contradictory and that implementation is cohesive. It is crucial to have a shared understanding of what reform is intended to achieve and how objectives are balanced against one another. There should be overall clarity on the direction of reform, the rationale for change and the role that different institutions will play throughout the process, for example through a shared workplan with clear roles and responsibilities. Aligning reform with wider economic, social and environmental policy rather than narrow environmental or economic measures is key during periods of geopolitical uncertainty, when governments need to demonstrate they are responsive to citizens' concerns. For example, in Indonesia, EHS reform did not fully address incentives for changes in fuel consumption, leading to mixed results, the need for further rounds of reform and ultimately political backlash.¹⁰ Coherent political leadership can help establish a comprehensive approach that provides clarity to citizens.⁹

Building support beyond government

Business owners, workers and unions, along with other non-governmental actors have a role to play in determining the feasibility and outcomes of reform and encouraging governments to act. In the case of Egypt, an informal coalition including technocrats and businesses encouraged government to change its existing subsidy framework, which they felt had led to social inequality and increased risk of civil unrest, especially in a post-Arab Spring context.¹¹

Early stakeholder engagement can inform governments on existing EHS and identify potential unintended consequences of reform, such as recreating perverse incentives for business and small-scale producers. This will help to design in positive incentives that better align with environmental and social objectives. Meaningful stakeholder participation can also create ownership among groups that are expected to change their behaviour and business operations.

Communications campaigns

Subsidy reforms are a highly visible interventions because they affect prices, real incomes and access to goods and services. It is therefore

Box 1. The role of businesses in EHS reform

Businesses have an incentive to engage in EHS reform processes because subsidies ultimately distort markets. For example, in Nigeria the removal of fossil fuel subsidies created incentives for off-grid solar, leading to the market growing by a factor of 10 in two years. Further, by funding overconsumption of fossil fuels and nature resources, EHS increase financial risks, especially in sectors sensitive to environmental change such as agriculture, fishing and water, increasing the urgency of reforms. Businesses can actively engage and build government confidence¹² to advance EHS reform by:

- **Considering** how business operations and models are affected by existing subsidies, including how they influence operating costs and/or create competitive disadvantages. For example, how will subsidies reform and repurposing affect customers' purchasing power?
- **Understanding** how subsidies incentivise environmentally destructive practices that damage an ecosystem on which the business depends, or how the company is susceptible to climate impacts that are amplified by subsidised emissions. Understanding the risks that EHS impose on businesses is also relevant to financial institutions, including insurers.
- **Engaging** with governments to undertake subsidies reform, including through consultations to share findings from previous steps and identify how reforms could incentivise more sustainable businesses practices and reduce risk exposure.

important for governments to communicate changes, and any mitigating measures, effectively with stakeholders, including vulnerable households, producer organisations and trade unions. Without this communication, there is risk of losing support, and facing protests and unrest. In Colombia, the government attempted to reform diesel subsidies, but attracted widescale protests from the transport sector which argued that there were insufficient measures in place to mitigate the impacts on the transport sector. Further analysis has found that better communication and consultations between the government and the transport sector could have prevented discontent, while more targeted messaging could have increased public support.¹³

Communication should begin before any reform is implemented. It should clearly lay out why the existing system no longer delivers the desired outcomes, who will be negatively or positively affected, and what support will be available to those negatively affected. Targeted communication across different demographics and sectors can make it more credible and inform the support programmes.

Complementary measures to mitigate risks

Designing and implementing complementary social programmes based on distributional analysis of existing and proposed subsidy frameworks can support citizens negatively

impacted by EHS reform. Women, low-income households, informal workers and small-scale producers, among other groups, may experience changes in prices, employment or access to resources differently. Identifying these effects and offering support before reform is implemented can ensure it reaches those most in need.

Where reforms disproportionately increase costs for vulnerable households, targeted social safety nets can protect livelihoods and food and energy security, without blocking governments from decreasing blanket subsidies that are costly or inefficient.¹⁴ For example, in Egypt, when the government identified that fossil fuel subsidy reform would impact the price of transport, it provided free public transport in the short term, focused in urban areas. Targeting support programmes to vulnerable groups can increase fiscal efficiency while decreasing overall government expenditure and environmental impact.

Additionally, existing government programmes can be expanded or adapted. This includes investing in positive incentives for environmental stewardship such as natural resource management plans and enforcement, rights and baseline demographic data. Connecting different types of subsidies, such as income support and positive incentives for sustainability, and integrating features such as environmental conditions into traditional support programmes, can also increase cohesion between complementary measures.¹⁵

Considerations for policymakers

Increased geopolitical and economic uncertainty can make EHS reform harder, but they can drive more effective public expenditure and deliver social and environmental benefits. Key

considerations for policymakers embarking on EHS reform include:

- Start by assessing the existing subsidy, including understanding its original objective, the target beneficiaries and who is benefiting in reality. This can provide an environmental and socioeconomic baseline against which to measure improvement. The UNDP's 'The Nature of Subsidies' is a useful tool to do so.⁸
- Identify the macroeconomic factors that influence market prices for the goods and products affected by the subsidies that are targeted to change. Where products are influenced by international markets (for example, cereals, fossil fuels or rare minerals), identify nearby, stable and politically aligned trade partners. This will help mitigate volatility.
- Look to repurpose rather than solely remove the EHS. Identify where resources could be channelled to more effectively deliver environmental objectives, fiscal sustainability and socioeconomic resilience.¹⁶
- Engage non-government stakeholders early in the process, including businesses, unions and producer organisations.¹¹
- Communicate clearly and consistently the purpose of changes, how existing support will be continued or replaced, and how negatively affected groups will be supported.¹¹
- Ensure that monitoring and evaluation frameworks are in place and budgeted for. This will allow for adaptive management of the new incentive framework, and collect evidence to demonstrate benefits to all stakeholders.¹⁷

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Knowledge Products

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Notes

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Our work on environmentally harmful subsidies reform is being undertaken as a part of IIED's 'Transforming environmentally harmful subsidies for business and nature' project. Find out more about this work at: www.iied.org/transforming-environmentally-harmful-subsidies-for-business-nature

