07/06/2024

EU fossil fuel subsidies on the rise again

Climate Action Network (CAN) Europe is Europe's leading NGO coalition fighting dangerous climate change. With over 200 member organisations active in 40 European countries, representing over 1,700 NGOs and more than 40 million citizens, CAN Europe promotes sustainable climate, energy and development policies throughout Europe.

A drastic change of course is needed to phase out EU fossil fuel subsidies by 2025.

Introduction

Phasing out fossil fuel subsidies in a socially just manner is essential for hitting ambitious climate targets. As analysed in a previous CAN Europe report[i], fossil fuel subsidies are undermining the effectiveness of carbon price signals, putting renewable energy and efficiency investments at a competitive disadvantage, and wasting precious public resources that are desperately needed for financing a just energy transition and climate action. Crucially, phasing out and redirecting fossil fuel subsidies would contribute to mobilizing additional public investments in renewable energy, particularly wind and solar, energy efficiency, distribution infrastructure for electrification, and demand-side flexibility options including storage, batteries and electrified transport as well as their enablers such as smart meters.

It is for these reasons that the EU and all its Member States have repeatedly pledged to end “inefficient fossil fuel subsidies” since 2009 while “encouraging all countries to do so” by 2025 at both the G20 and the UNFCCC. At COP26, parties to the UNFCCC committed to phase out inefficient fossil fuel subsidies for the first time and 34 countries, of which 12 EU Member States, pledged to end their international public finance for fossil fuel energy projects.

The G7 Climate, Energy and Environment Ministers reiterated the commitment to phase out “inefficient” fossil fuel subsidies in a 2024 Communiqué ahead of the G7 Summit of June 2024[ii].

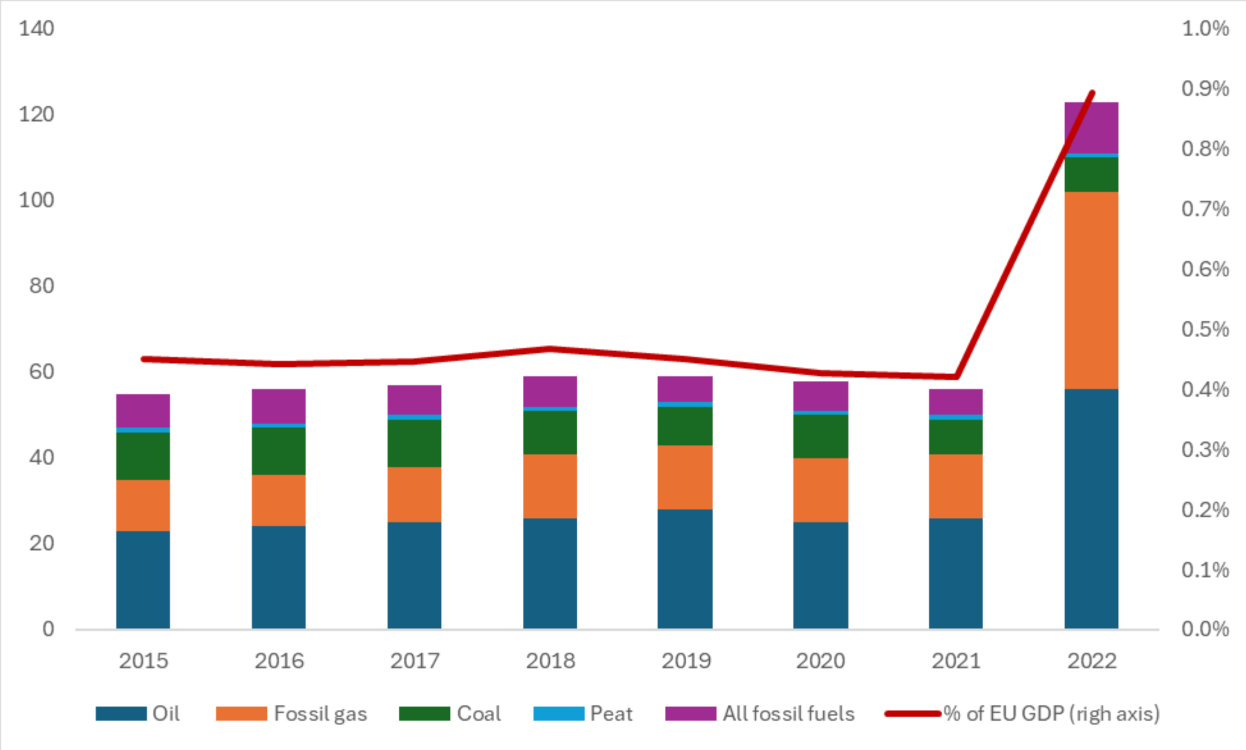
However, these commitments are still falling short on implementation, as the EU and its Member States are failing to walk the talk: instead of a gradual decline of fossil fuel subsidies, the latter is in fact on the rise, putting in jeopardy the goal of hitting the 2025 deadline.

Bouncing backwards rather than forward.

Indeed, despite a moderate reduction in 2021 compared to the 2019 level, fossil fuel subsidies more than doubled in 2022, as a consequence of the response to the energy crisis following the Russian invasion of Ukraine (Figure 1).

Although the objective of shielding vulnerable households from rampant energy costs was necessary to prevent an increase in energy poverty in the short term, several reports have evidenced that those subsidies were by and large poorly targeted and failed to support transformative investments benefiting energy-poor households (e.g. through heat pump installations or renovation investments) [iii][iv]. In addition, other measures that could have supported energy-poor households were not systematically put in place, such as using utility providers' profits to finance social tariffs or preventing rent indexation for leaky housing.[v] In short, both the EU and its Member States have been subsidizing the production and consumption of the very same fossil energy sources that triggered the energy crisis in the first place.

Figure 1: Evolution of explicit fossil fuel subsidies by category (Euros 2022, billion – left axis) and as % of EU GDP (right axis)



Source: CAN Europe based on European Commission and Eurostat

Crucially, despite the urgent need to eliminate the EU's external dependence on fossil gas following the Russian invasion of Ukraine, subsidies for renewable energy sources across the EU (EUR 87 billion) remained inferior to fossil fuel subsidies (EUR 123 billion) in 2022[vi].

According to IMF forecasts for 2023, fossil fuel subsidies in the EU can be expected to decline to USD 88 billion in 2023 and USD 78 billion in 2024 (from USD 120 billion in 2022) as the impact of the energy price shock is waning; they are expected remain, however, far above the levels of the 2015-2021 period.

These figures do not even account for so-called “implicit fossil fuel subsidies” which consist of the unpaid externalities due to insufficient carbon pricing in several economic sectors (e.g. free European Trading Scheme allowances handed to corporations) as well as broader indirect subsidies, for example in transport sector infrastructure [vii] [viii].

At this rate of decline, fulfilling the commitment of phasing out explicit fossil fuel subsidies by 2025 seems unlikely to happen without an immediate and drastic policy shift both at the level of the EU and in individual Member States.

The EU is not walking the talk: policy developments against the 2025 commitment.

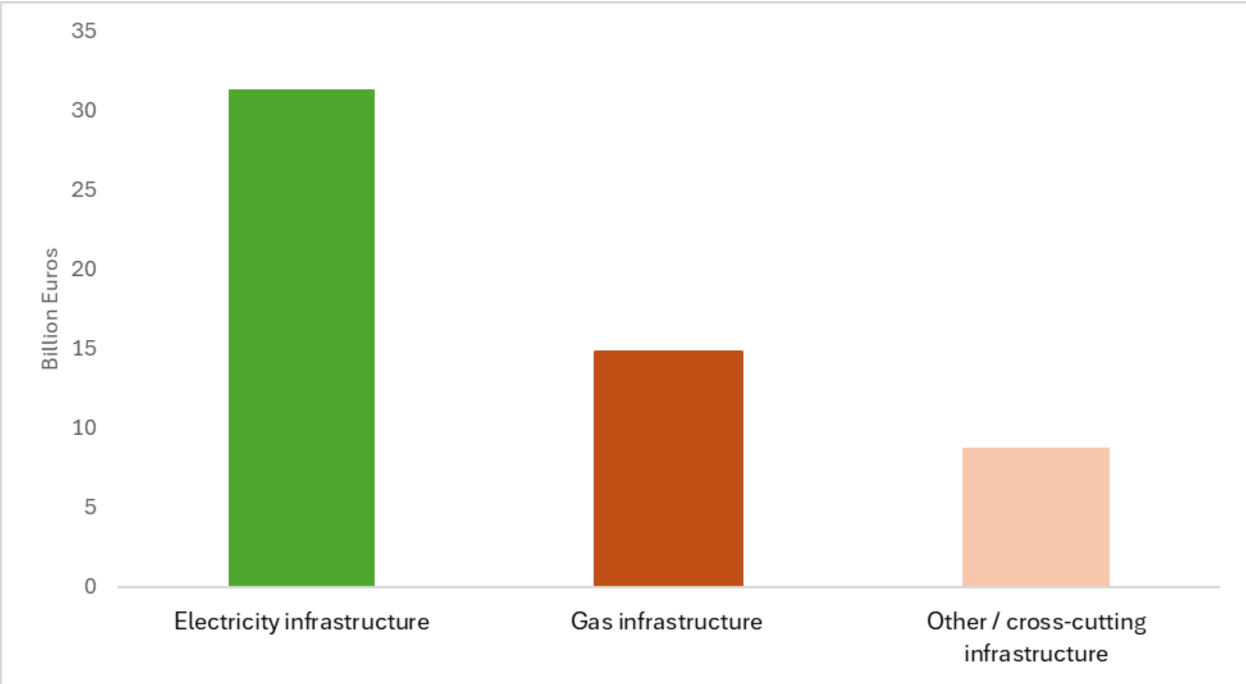
In the EU, fossil fuel subsidies can be classified under two categories: those coming from Member States’ budgets, on which the EU has more limited control, and those coming directly from the EU budget.

Although the overwhelming majority of fossil fuel subsidies in the EU come from national budgets, EU funds are important for the provision of investment subsidies for new energy infrastructure (as opposed to subsidies for the generation and consumption through existing infrastructure) which risk locking the EU’s energy model in fossil fuels for decades. Furthermore, it is essential for the EU to exclude support for fossil fuel investments in its own funds if it is to set a positive example for Member States to phase down national level subsidies. Finally, beyond subsidies dedicated to EU infrastructure, the EU budget still provides investment subsidies for fossil fuel infrastructure projects in third countries in its external action instruments. For example, the RePowerEU External Energy Strategy targets liquid natural gas (LNG) imports from Egypt and West Africa and fossil gas through pipeline diversification from Algeria and Azerbaijan, and to this end, the EU has signed Memoranda of Understanding with a number of these countries to guide cooperation on energy.

The possibilities to finance fossil fuel investments through EU budget instruments have progressively been tightened in the 2021-27 EU budget through the permanent exclusion of support for coal and oil investments. However, selected midstream and downstream fossil gas investments are still eligible in the largest EU funds, namely Cohesion Policy funds and the EUR 750 billion strong Recovery and Resilience Facility.

Furthermore, instead of a further tightening of conditions for financing fossil fuel projects, the introduction of RepowerEU (as a response to the energy crisis triggered by the Russian invasion of Ukraine) resulted in widening the scope of eligible gas investments by including LNG related infrastructure that was previously ineligible for finance through EU funds[ix]. As a result, Member States are still using substantial amounts of EU funds that should be dedicated exclusively for a clean energy transition, for financing new fossil fuel infrastructure.

Figure 2: Energy related infrastructure investments in a sample of 18 Recovery and Resilience Plans



Source: CAN Europe based the Green Recovery Tracker[x]

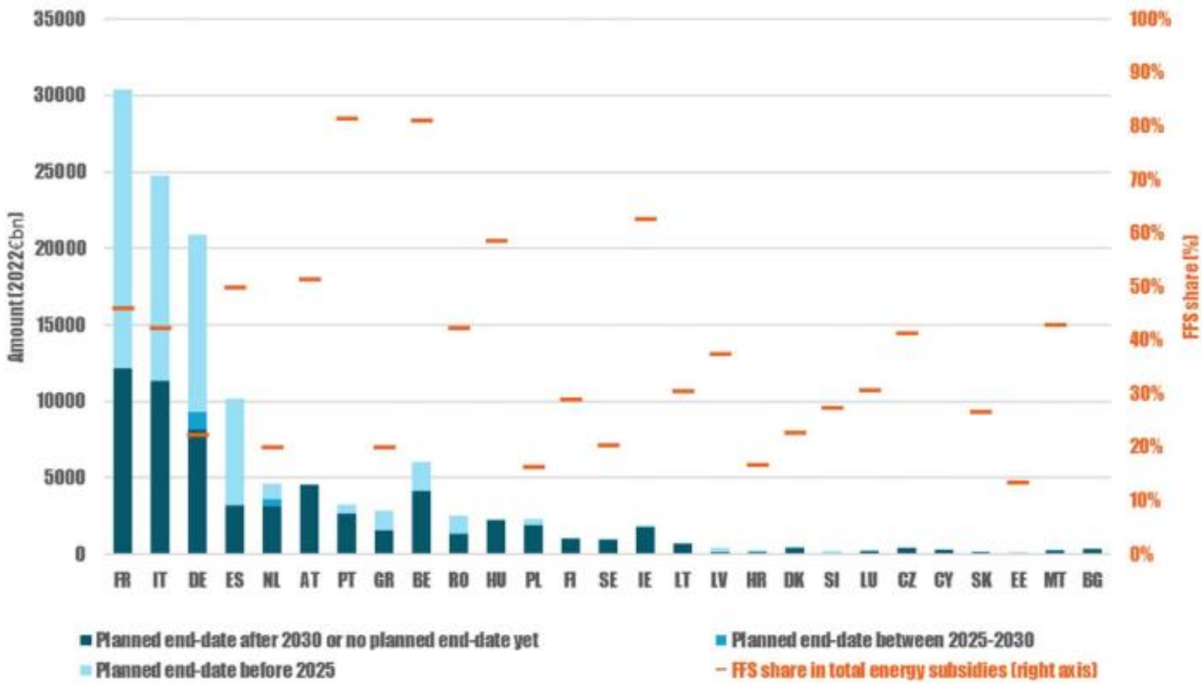
Fully excluding any support for new fossil fuel infrastructure in EU funds from 2025 onward would require amending existing EU regulations for the 2021-27 long-term EU budget. Falling short of this, eligibility rules are unlikely to change before the introduction of the next long-term EU Budget (which will set new eligibility rules for EU-financed investments). At the very minimum, walking to talk on phasing out fossil fuel subsidies would require an unequivocal commitment by the EU to fully exclude any support for fossil infrastructure in all funding instruments of the 2028-34 EU budget.

Member States are not walking the talk: limited commitments to shift national budgets.

The EU's 8th environment action programme requires both the Commission and Member States to "setting a deadline for the phasing out of fossil fuel subsidies consistent with the ambition of limiting global warming to 1.5°C"[xi].

According to a preliminary assessment of the National Energy and Climate Plans (NECPs) undertaken by the European Commission, so far only 6 of the 27 EU Member States have expressed their intention to fully phase out fossil fuel subsidies in their national budgets, albeit with no concrete end dates. Based on this assessment and other national plans and announcements, less than half of 2022 fossil fuel subsidies have a planned end date before 2025, 1% are planned to be phased out between 2025 and 2030, while 52% do not have an end date set even for after 2030 (figure 3).

Figure 3: Fossil fuel subsidies by end-date and share of total energy subsidies (%) in 2022



Source: Enerdata and Trinomics[xii]

Beyond the responsibility of individual Member States, and the fact that fiscal policy remains a national prerogative, the EU should play a greater role to ensure commitments made are effectively implemented. Not decarbonizing our economy fast enough is generating an existential threat for all, and is increasingly affecting the European economy. It is everyone’s business.

First, the European Semester process is the main economic policy coordination mechanism of the EU. Through the issuance of Country Specific Recommendations (CSRs) every Spring, the European Commission can recommend reforms to individual Member States. Those reforms should, in theory, be acted upon within the annual budget on Member States in the following Autumn of the same year. Furthermore, reforms mentioned in Country Specific Recommendations constitute reform prerequisites for disbursement of RRF funds. However, CAN Europe’s analysis of the 2023 European Semester process illustrates that recommendations to phase out fossil fuel subsidies, or to commit to a phase-out date were absent for the overwhelming majority of Member States despite those being mentioned descriptively in the EU Semester reports[xiii].

Figure 4: Fossil fuel subsidies in the 2023 European Semester process

Member State	**Fossil fuel subsidies mentioned in Semester Report**	**Fossil fuel subsidies phase out in Country Specific Recommendations**
Belgium	Considered	Not explicitly included
Bulgaria	Considered	Not explicitly included
Croatia	Considered	Not explicitly included
Czech Republic	Considered	Not explicitly included
Estonia	Considered	Not explicitly included
France	Considered	Not explicitly included
Germany	Considered	Not explicitly included
Greece	Considered	Not included
Hungary	Considered	Included
Ireland	Considered	Included
Italy	Considered	Not explicitly included
Latvia	Considered	Not explicitly included
Lithuania	Considered	Not explicitly included
Netherlands	Considered	Not explicitly included
Poland	Considered	Not explicitly included
Portugal	Considered	Not explicitly included
Romania	Considered	Not explicitly included
Slovakia	Considered	Not explicitly included
Slovenia	Considered	Not explicitly included
Spain	Considered	Not explicitly included
Sweden	Considered	Not explicitly included

Source: CAN Europe assessment of 19 Semester and CSR reports[xiv] [xv]

Another example of the way EU rules can affect national budget decisions is through State Aid rules, which form the regulatory framework which sets boundaries to the resources (subsidies) that Member States can provide to companies (undertakings). When it comes to the phase-out of fossil fuel subsidies, existing State aid rules remain inadequate: aligning them with the commitment to phase out fossil fuel subsidies by 2025 requires, at minimum, a roadmap to fully exclude subsidies for fossil fuel-based (including the so-called “low carbon” or “hydrogen ready”) energy projects and industrial companies (for further details see: CAN Europe, 2023[xvi]).

Conclusion

Despite repeated pledges to phase out fossil fuel subsidies by 2025 at both G7 and the UNFCCC, current EU policies are not up to the task of delivering this target. To maintain any hope of achieving this target, the EU should among others:

- Immediately amend existing EU regulations on the current EU budget (2021-27) to preclude any possibility of providing support to new fossil fuel infrastructure through EU funds after 2025.
- Align State Aid rules with the EU's commitment to phase out fossil fuel subsidies by 2025.
- Strengthen Country Specific Recommendations by explicitly recommending the phase-out of fossil fuel subsidies in national budgets and their redirection to support for renewables, energy efficiency, and related electrification infrastructure, in a socially just way; the implementation of recommendations related to fossil fuel subsidies could be set as a precondition for the disbursement of future EU funds – linking payments to reforms.
- Ensure that the revised National Energy and Climate Plans submitted by Member States entail a concrete roadmap for the phase-out of the totality of fossil fuel subsidies, on an economy-wide basis, as a precondition for their approval. Member States should also make more effort to assess and plan measures to ensure a fair and just transition in their National Energy and Climate Plans (NECPs). This includes proposing accessible and affordable alternatives for people, micro-enterprises and SMEs likely affected by the phase-out of consumption-oriented fossil fuel subsidies.
- Close loopholes allowing fossil fuel finance in external action instruments, except support for clean cooking solutions to tackle health and poverty impacts in limited circumstances. A strong 'do no significant harm' list of investments should be set out for all instruments under the Global Gateway and around guarantee and blending operations of the European Fund for Sustainable Development Plus (EFSD+).

Further detailed recommendations can be accessed in CAN-E's comprehensive report on fossil fuel subsidies phase-out[xvii].

CONTACTS

OLIVIER VARDAKOULIAS: Economist / Finance and Subsidies Coordinator, olivier.vardakoulias@caneurope.org

JANI SAVOLAINEN: Communications Coordinator, jani.savolainen@caneurope.org

info@caneurope.org

Facebook LinkedIn Twitter

Endnotes

---

[i] Cornelia Maarfield, Isabelle Brachet, Olivier Vardakoulias, Rachel Simon (2023). Fossil fuel subsidies in the EU. CAN Europe report. https://caneurope.org/content/uploads/2023/03/Fossil-Fuels-Subsidies-Report.pdf

[ii] G7 Italy (2024). Climate, Energy and Environment Ministers' Meeting Communiqué https://www.g7italy.it/wp-content/uploads/G7-Climate-Energy-Environment-Ministerial-Communique_Final.pdf?utm_campaign=IEA+newsletters&utm_medium=Email&utm_source=SendGrid

[iii] Hemmerlé, Y., et al. (2023), "Aiming better: Government support for households and firms during the energy crisis", *OECD Economic Policy Papers*, No. 32, OECD Publishing, Paris, https://doi.org/10.1787/839e3ae1-en.

[iv] NGOs joint letter on alternative solutions to fossil fuel tax cuts, 2022, https://eeb.org/wp-content/uploads/2022/04/NGOs-joint-letter-alternative-solutions-to-fossil-fuel-tax-cuts.pdf and Transport & Environment, Cuts to fuel taxes, 2022, https://www.transportenvironment.org/challenges/climatetools/fuel-taxes/cuts-to-fuel-taxes/. Practically all MS introduced new subsidies for other fossil fuels, especially gas: https://www.bruegel.org/dataset/national-policies-shield-consumers-rising-energyprices

[v] A People-Powered Plan to Exit Europe's Energy Price Crisis, Right to energy coalition, 2023, https://caneurope.org/content/uploads/2023/12/People-Powered-Winter-Plan.pdf

[vi] European Commission, Directorate-General for Energy, Bon-Mardion, J., Casteleyn, M., Queenan, J. et al. (2023). *Study on energy subsidies and other government interventions in the European Union – Final report – 2023 edition*, Publications Office of the European Union, 2023, **https://data.europa.eu/doi/10.2833/571674**

[vii] Simon Black ; Antung A. Liu ; Ian W.H. Parry ; Nate Vernon (2023). IMF Fossil Fuel Subsidies Data: 2023 Update. https://www.imf.org/en/Publications/WP/Issues/2023/08/22/IMF-Fossil-Fuel-Subsidies-Data-2023-Update-537281

[viii] See for example: Green Recovery Tracker (2021). Recovery investments and the green mobility transition. https://assets.website-files.com/602e4a891047f739eaf5dfad/61bae8af36c9845474dbd030_GRT_2021_EU%20Mobility%20and%20Recovery%20Deep%20Dive.pdf

[ix] CAN Europe, Comments on the proposal to amend the Recovery and Resilience Facility regulation in the context of REpowerEU, 2022, https://caneurope.org/comments-on-rrf-of-repowereu/

[x] Felix Heilmann (2021). Recovery Investments and the European energy transition. Green Recovery Tracker publication. https://assets.website-files.com/602e4a891047f739eaf5dfad/610127ec9366c37d62e3f1f4_GRT_2021_EU%20Energy%20and%20Recovery%20Deep%20Dive.pdf

[xi] Article 3 (h) (i) of Decision (EU) 2022/591 of the European Parliament and of the Council of 6 April 2022 on a General Union Environment Action Programme to 2030.

[xii] European Commission (2023). Report on Energy Subsidies in the EU. COM/2023/651 https://energy.ec.europa.eu/system/files/2023-10/COM_2023_651_1_EN_ACT_part1_v4.pdf

[xiii] CAN Europe (2023). Letter - aligning Country Specific Recommendations and fiscal rules with ambitious

environmental and climate goals. https://caneurope.org/content/uploads/2023/07/NGOs-Letter_CSRs_Fiscal-Framework_July-2023.pdf

[xiv] European Commission (2023). European Semester Country Reports. https://economy-finance.ec.europa.eu/publications/2023-european-semester-country-reports_en

[xv] European Commission (2023). European Semester Country Specific Recommendations. https://commission.europa.eu/publications/2023-european-semester-country-specific-recommendations-commission-recommendations_en

[xvi] Cornelia Maarfield, Isabelle Brachet, Olivier Vardakoulias, Rachel Simon (2023). *Op. Cit*

[xvii] Cornelia Maarfield, Isabelle Brachet, Olivier Vardakoulias, Rachel Simon (2023). *Op. Cit*