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Fossil fuel subsidies and the European Semester

progress or regression?

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.

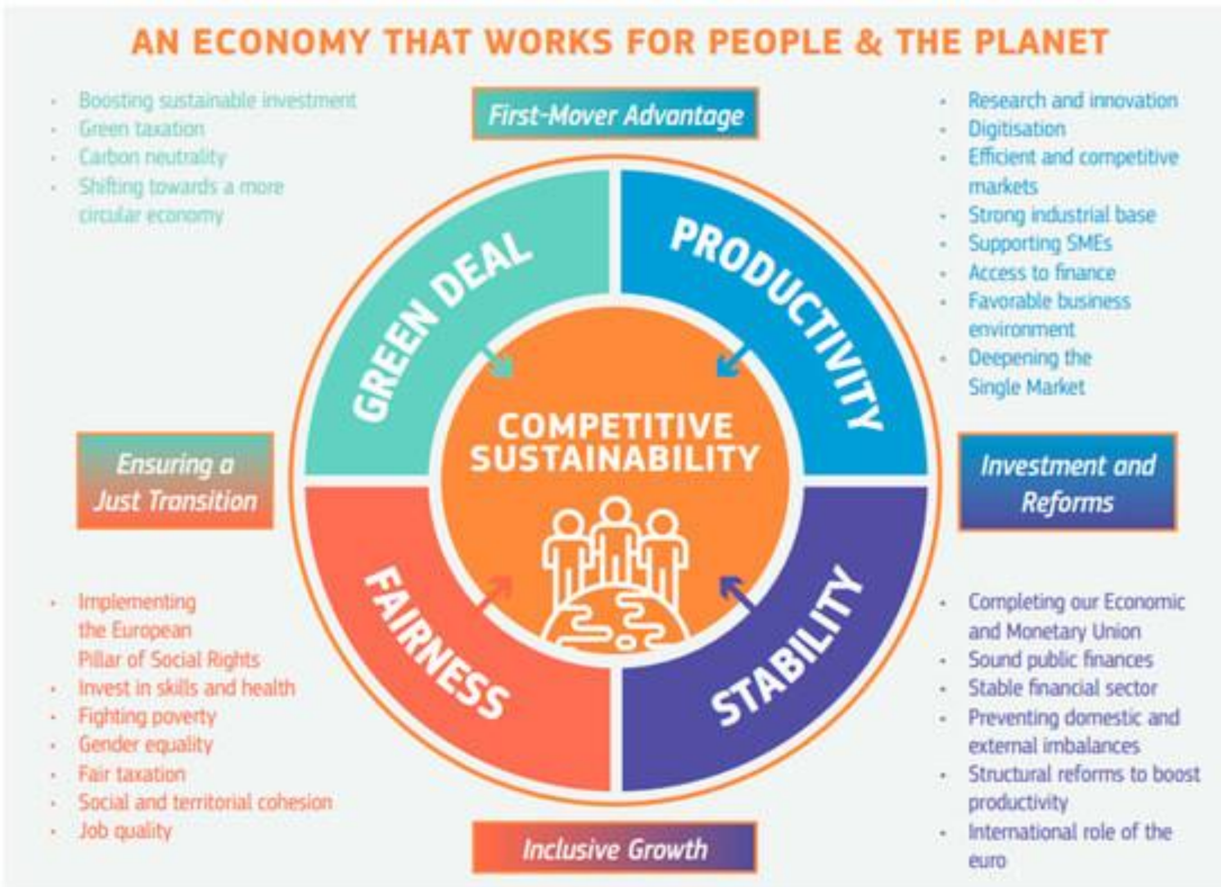
Introduction

Although the European Union has committed to “phase out inefficient fossil fuel subsidies by 2025”, in several international fora such as the G7 and the UNFCCC, in practice this commitment has very poorly translated, if at all, into national fiscal policies. Indeed, as previously assessed in a CAN Europe briefing, fossil fuel subsidies remain on the rise, and are not forecasted to decline over the coming years[i]. This is highly problematic as 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[ii].

Although national Member States maintain their prerogative over fiscal policy, since 2010 the European Semester was established in order to promote a better coordination of fiscal, economic and (initially to a lesser extent) social policies across the Union following the financial crisis of 2008. In a nutshell, for all its limitations, the Semester process is the main economic and social policy coordination mechanism at EU level.

Initially, the European Semester process consisted mostly of steering macroeconomic and fiscal policies independently of wider Union priorities. Since 2020, however, the scope of the Semester process has been broadened to include “common priorities” of the Union, including progress of Member States towards achieving Sustainable Development Goals (SDGs), and Deal objectives[iii]. The revised framework (see figure 2 below) has been structured around so-called “competitive sustainability”, namely environmental sustainability, fairness, productivity gains and macroeconomic stability[iv]. This has also entailed enhancing the guidance on the implementation of the European Pillar of Social Rights, which was initially incorporated (albeit to a lesser extent) within the Semester process in 2018. The European Semester is also enshrined in the Preventive Arm of the Stability and Growth Pact as reformed in 2024[v].

Figure 1: Framework presented in the 2020 European Semester’s Annual Sustainable Growth Strategy



Source: European Commission[vi]

As such, examining how elements that are at the intersection between fiscal and climate policy are being addressed under the European Semester, is crucial. The present briefing updates our assessment of the extent to which the 2023 Semester process recommended the phasing out of fossil fuel subsidies in 21 Member States, examining the 2024 Semester process[vii].

Our findings suggest that, compared to 2023, there is a clear regression in both documenting the evolution of fossil fuel subsidies country Semester reports, as well as recommending their phase-out within Country Specific Recommendations. The lack of consistent approach is a missed opportunity given the EU's repeated commitment to phase out fossil subsidies by 2025.

Brief overview of the EU Semester process

The Semester process entails several stages, split into two broad "packages" (see Annex 1 below for the detailed process). The "Autumn package" takes stock of the European Union's socio-economic performance (including employment) and adopts Union-wide priorities for the coming year, whilst the "Spring package" (a) assesses the socio-economic performance of individual Member States within country Semester reports, including among other progress reports their national medium-term fiscal-structural plans or related progress, and (b) recommends Country Specific Recommendations (CSRs), based on Semester reports. CSRs adopted in early Summer of each year, which consist of broad reform directions, should notionally be incorporated by Member States into their national Budgets, adopted in Autumn.

In practice, according to the European Court of Auditors, the majority of CSRs have historically been either not adopted or only partially adopted in national decision-making as the incentives for compliance have been limited[viii]; furthermore, recommendations seeking to achieve "fiscal consolidation" have often been in direct contradiction (see sections below) with both climate and social objectives, by recommending reforms that reduce fiscal capabilities for climate action and/or that are socially regressive (e.g. reforms to pension systems, long-term care and social protection expenditures).

In the context of these contradictions, incorporating reforms that consist in integrating climate and green deal policies within fiscal and economic policies in a consistent manner is important for several reasons:

- First incorporating such reforms provides a clear policy signal to Member States to align fiscal and economic policy with the achievement of climate, Green Deal and just transition objectives even if reforms are not adopted, or partially adopted by Member States.
- Second, the reformed EU Economic Governance Framework provides clear incentives for complying with common priorities of the Unions, including energy security, a fair green transition, and CSRs - as Member States can benefit from a longer public debt and deficit adjustment period in exchange for adopting and implementing investments and reforms serving those goals or addressing the challenges identified in the CSRs.
- Third, the funding architecture adopted in the Recovery and Resilience Facility (linking investments with reforms) is likely to be expanded to other EU budget instruments by the European Commission, in its proposals for the 2028-34 Multiannual Financial Framework. In that case, CSRs may be used by Member States to identify reforms serving common objectives, as has been the case in Recovery and Resilience Plans.

Overall, given that CSRs are likely to gain more weight in the future, it is crucial to assess whether, and to what extent, the reforms proposed by the Commission and the Council are genuinely aligned with climate, green deal and just transition targets. This briefing focuses on one aspect, namely fossil fuel subsidies, while future briefings will focus on additional facets of the energy transition and the Green Deal's incorporation within the Semester process.

Phasing out fossil fuel subsidies should be central to the European Semester

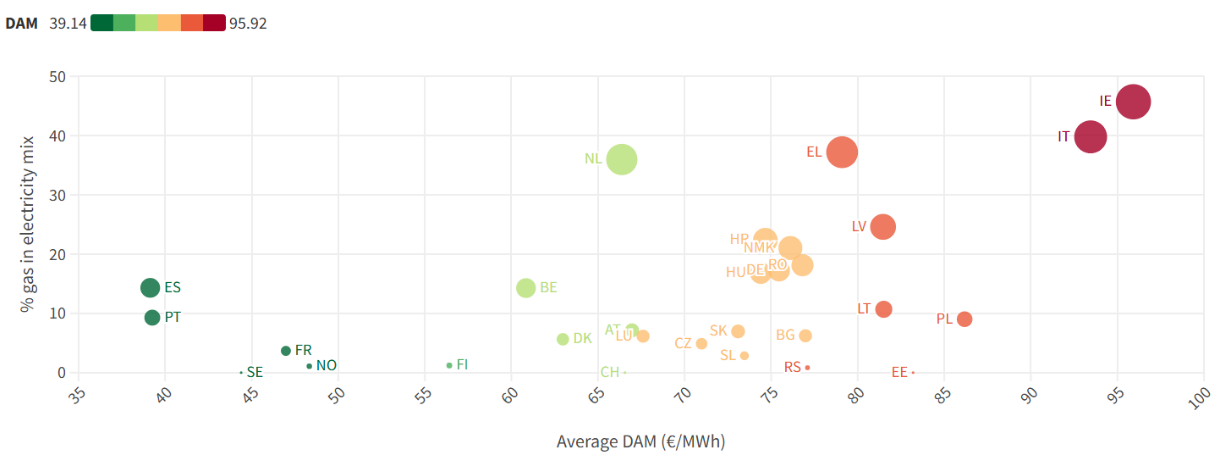
As aforementioned, since 2020 the performance of Member States against Green Deal targets, including the energy transition, has been tracked systematically in the Semester process – a very positive development. However, the respective assessments of macroeconomic, fiscal and climate performance have remained siloed and compartmentalized: the degree of alignment of economic and fiscal policies with SDGs, Green Deal objectives, and the European Climate Law, most notably, are not sufficiently analysed – among which fossil fuel subsidies. Along with other economic policies directly affecting the achievement of Green Deal targets (e.g. green budgeting practices, green procurement, green investment mobilisation) the latter are of both climate and economic policy relevance and should consequently be assessed within the Semester process and included in Country Specific Recommendations.

Macroeconomic policy relevance

Beyond strict environmental dimensions, the phase out of fossil fuel subsidies is macroeconomically relevant for Europe's socio-economic performance.

Following several other assessments, the report on the future of European competitiveness by Mario Draghi endorses the idea that the shift away from fossil fuels by transitioning to renewables is a sine qua non for ensuring Europe's future competitiveness, by enabling a move away from imported fossil fuels and associated price volatility[ix]. For example, evidence suggests that high electricity prices across the EU are strongly correlated with gas penetration in the electricity within Member States (Figure 2).

Figure 2: Correlation between gas share in electricity generation and Day Ahead Market prices in European countries, 1st Semester of 2024



Source: The Green Tank[x]

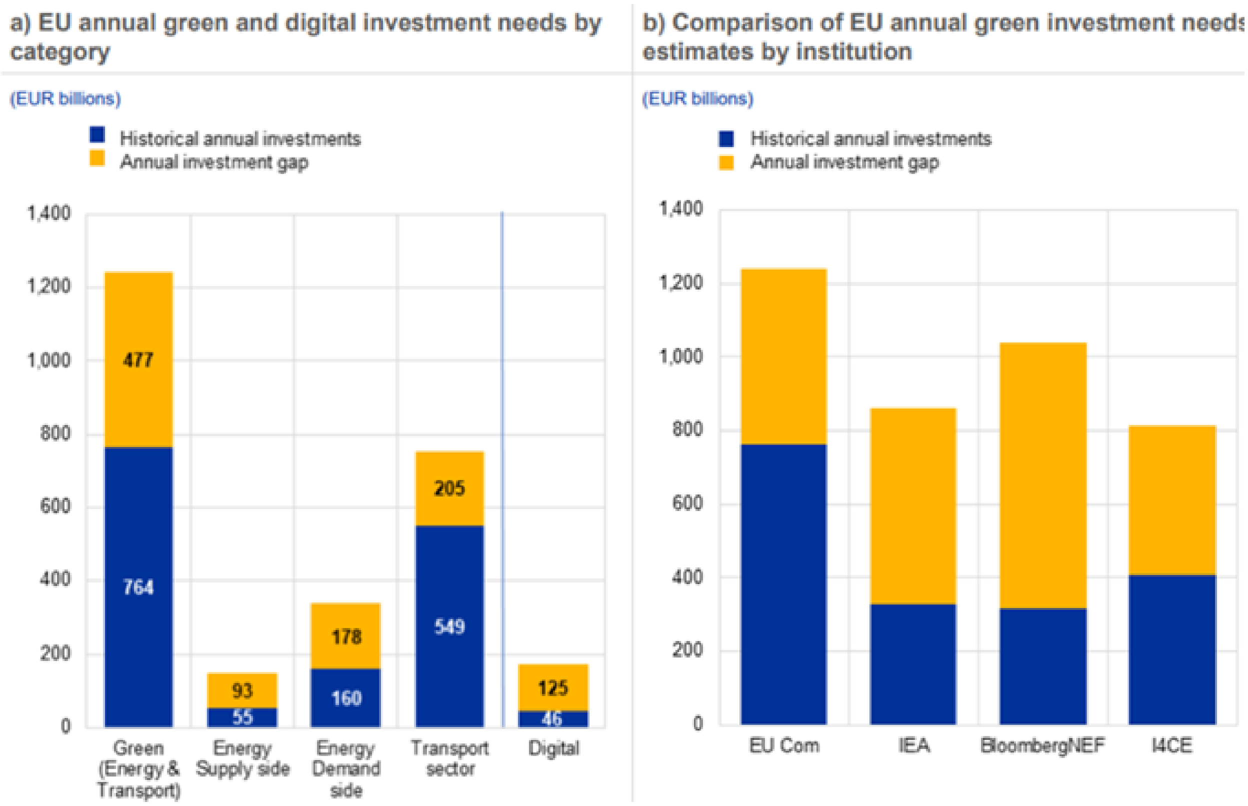
The dependence on fossil fuels consequently leads to higher energy prices, worsening energy poverty and inequalities whilst hampering macroeconomic resilience. Yet, fossil fuel subsidies are fueling the precise opposite outcomes: they artificially keep afloat less competitive fossil fuel infrastructure whilst reducing the relative competitiveness of renewable energy sources and associated infrastructure (e.g. grids, storage). Encouraging Member States for a socially just phase-out of fossil fuel subsidies should be part and parcel of European Semester reports and Country Specific Recommendations.

Fiscal policy relevance

Second, fossil fuel subsidies are depriving Member States from fiscal resources that could be used to fill the EU's climate investment gap.

Indeed, the EU faces sizeable investment needs and investment gaps for achieving ambitious climate targets: although estimations vary, the current levels of funding are not sufficient regardless of the methodology used, as assessed by the European Central Bank (figure 3).

Figure 3: EU climate investment needs.



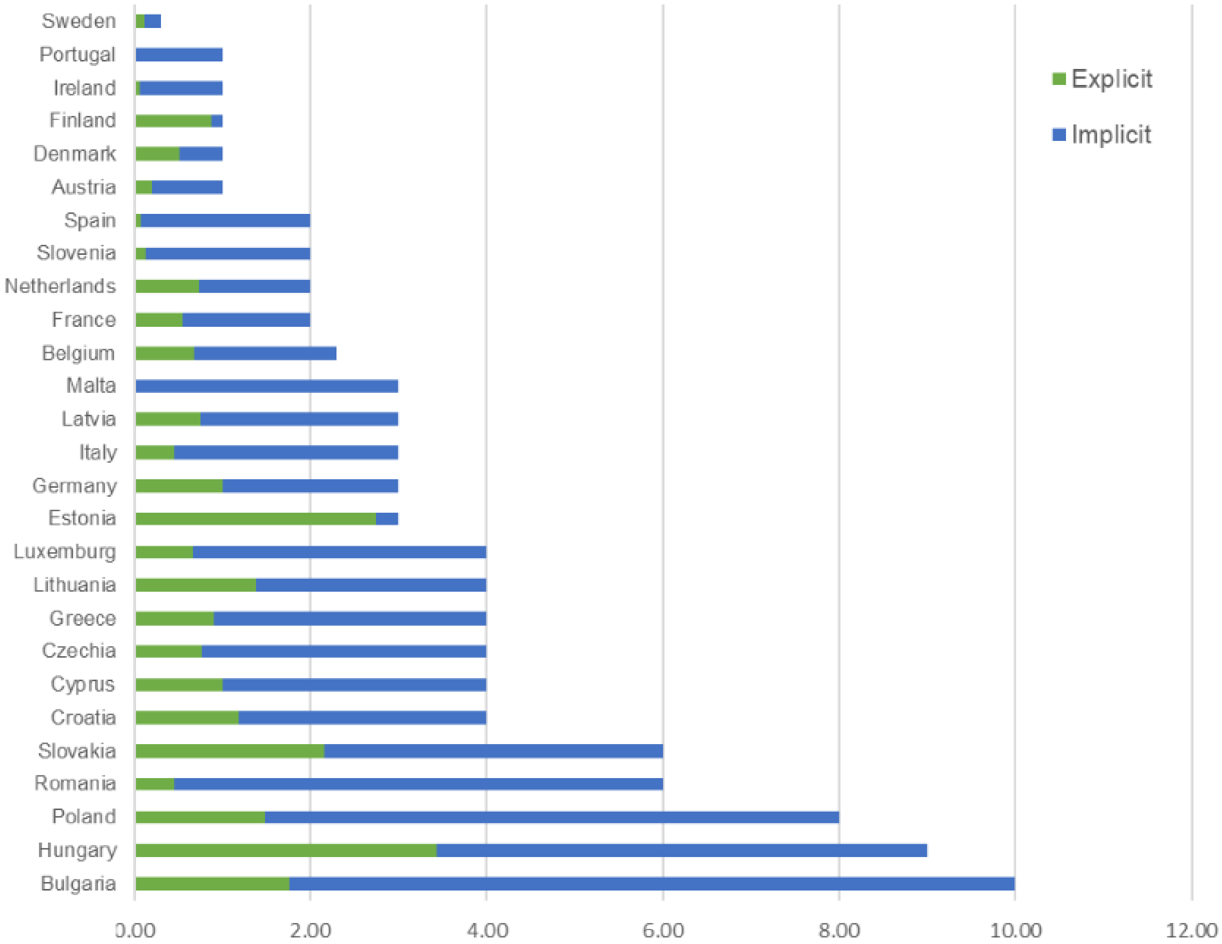
Source: European Central Bank[xi]

Depending on the source and methodology, between 40% and 60% of those investment needs can only be filled through public investment, either directly in the form of grants, or indirectly in the form of guarantees and subsidized finance more widely. Notwithstanding the importance of EU funds, all available estimates suggest that the latter are insufficient to fill public spending needs to meet climate and just transition targets. Moreover, the end of NGEU in 2026 would imply an additional funding gap, reducing the pool of available climate finance from the EU budget by approximately €300bn, shrinking the firepower of the EU budget.

Within this context, mobilizing national public investment is crucial for meeting climate targets; and, given that the new EU fiscal rules are hampering the possibilities of public borrowing-to-invest to provide additional resources, redirecting existing harmful expenditures towards climate and green deal objectives is of paramount importance to fill part of the spending gap.

Indeed, both direct (actual transfers) and indirect (unpaid externalities) subsidies represent a non-negligible fraction of national economies, funds that could be mobilized for financing a just energy transition (figure 4).

Figure 4: Explicit and implicit fossil fuels subsidies in 2022, % of GDP



Source: CAN Europe based on International Monetary Fund & Eurostat[xii]

Given the quantitative magnitudes, the climate stakes at play, and a context of fiscal austerity in large parts of the European Union, there is no fiscal policy rationale for failing to include fossil fuel subsidies phase-out within Semester reports and Country Specific Recommendations.

Assessment results for 2024

Our analysis of the 2024 European Semester cycle suggests a backtracking compared to 2023, with significantly fewer Semester reports assessing progress against the phase out of fossil fuel subsidies, and environmentally harmful subsidies more widely (figure 5). Likewise, only 2 of the 19 CSR reports recommend the phase out of fossil fuel subsidies, as was the case in 2023.

Figure 5: fossil fuel subsidies in the 2023 and 2024 Semester process

	2023	2024
Belgium	Partially considered	Considered
Bulgaria	Partially considered	Not considered
Croatia	Partially considered	Not considered
Czech Republic	Partially considered	Not considered
Estonia	Partially considered	Not considered
France	Partially considered	Partially considered
Germany	Partially considered	Partially considered
Greece	Partially considered	Not considered
Hungary	Considered	Considered
Ireland	Partially considered	Not considered
Italy	Considered	Partially considered
Latvia	Partially considered	Not considered
Lithuania	Partially considered	Not considered
Netherlands	Partially considered	Not considered
Poland	Partially considered	Not considered
Portugal	Partially considered	Partially considered
Romania	Partially considered	Partially considered
Slovakia	Partially considered	Not considered
Slovenia	Partially considered	Not considered
Spain	Partially considered	Partially considered
Sweden	Partially considered	Not considered

Colour Code	Definition
Considered	Included in Semester Report & Country Specific Recommendations
Partially considered	Included in Semester Report only
Not considered	Included in neither Semester report nor Country Specific Recommendations

Source: CAN Europe assessment of 19 European Semester and CSR country reports

Beyond the quantitative information, our qualitative assessment of Semester and CSR reports provides useful additional information.

First, the general needs (a) to scale down fossil fuel infrastructure and use, (b) reduce dependence and (c) diversify away from Russian fossil fuel imports, are present in all Semester reports – something undoubtedly positive. However, phasing out fossil fuel subsidies is scarcely mentioned as a crucial fiscal policy option to achieve these goals; or as a barrier for accelerating decarbonisation.

Second, even for the two Member States whereby the need to phase out fossil fuel subsidies is fully and explicitly mentioned, no dates or timelines are recommended. This presumably means that the EU's commitment to phase out fossil fuel subsidies by 2025 is omitted from the equation, in contradiction with the recommendations of the EU's 8th environment action programme, which required both the Commission and Member States to "set a deadline for the phasing out of fossil fuel subsidies consistent with the ambition of limiting global warming to 1.5°C"[xiii].

Third, one could expect a correlation between the inclusion of fossil fuel subsidies in the Semester and CSR reports and the actual weight of fossil fuel subsidies in respective Member States, in essence justifying why the need to phase them out is present in some Semester reports and CSRs but not in others. However, the correlation between the size of fossil fuel subsidies in national economies and their consideration in the Semester process is weak, if not inexistent (see figure 4 above).

Fourth, the fact that phasing out fossil fuel subsidies was included in previous years' CSRs could be an explanation: indeed, the implementation of CSRs is not time-bound and, as such, if already recommended in previous CSRs there would be no need to reiterate the same recommendation. However, this explanation does not hold for the overwhelming majority of the Member States we assessed. Indeed, the European Commission's database on CSRs allowed us to check whether phasing out fossil fuel subsidies was recommended over previous years[xiv]. With three exceptions (namely Italy, France and Belgium), we found no such recommendations in previous years' CSRs.

Finally, the lack of consistency in the Semester process is manifest. In 2023, virtually all Semester reports entailed a dedicated sub-section on environmentally harmful subsidies, and the need to phase them out and redirect them, in the context of the green transition. One would expect that, using available data and information, harmful subsidies would be tracked year-on-year within country Semester reports, to systematically assess progress. However, in numerous country reports, these sections were absent in 2024 with no obvious explanation.

Overall, our assessment points to a complete mismatch between the EU's declared objectives and timelines vis-à-vis the phase out of fossil fuel subsidies, and the main economic and fiscal policy coordination mechanism of the Union.

Conclusion and recommendations

Although fiscal policy remains a national prerogative, the EU should use the instruments at its disposal, even if those are not binding, to push for the integration of climate, environmental and socially just transition considerations within economic and fiscal policies – as commanded by the reformed EU economic governance framework. This, however, presupposes both a systematic assessment of those dimensions within Semester reports, and their integration within Country Specific Recommendations.

To this date, and despite substantial improvements post-2020, the assessment of Member States' progress against economic, social and environmental targets remain siloed within Semester reports, instead of being analysed in an integrated way: employment and social outcomes cannot be detached from wider fiscal policy, in the same way that the integration of climate considerations within fiscal and economic policies is of paramount importance to align public resources with the green transition.

Phasing out fossil fuel subsidies in a socially just way should be a central aspect of the Semester process, given the amply documented lack of progress by Member States, the fast-approaching 2025 deadline and the high relevance for fiscal sustainability. Indeed, 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[xv].

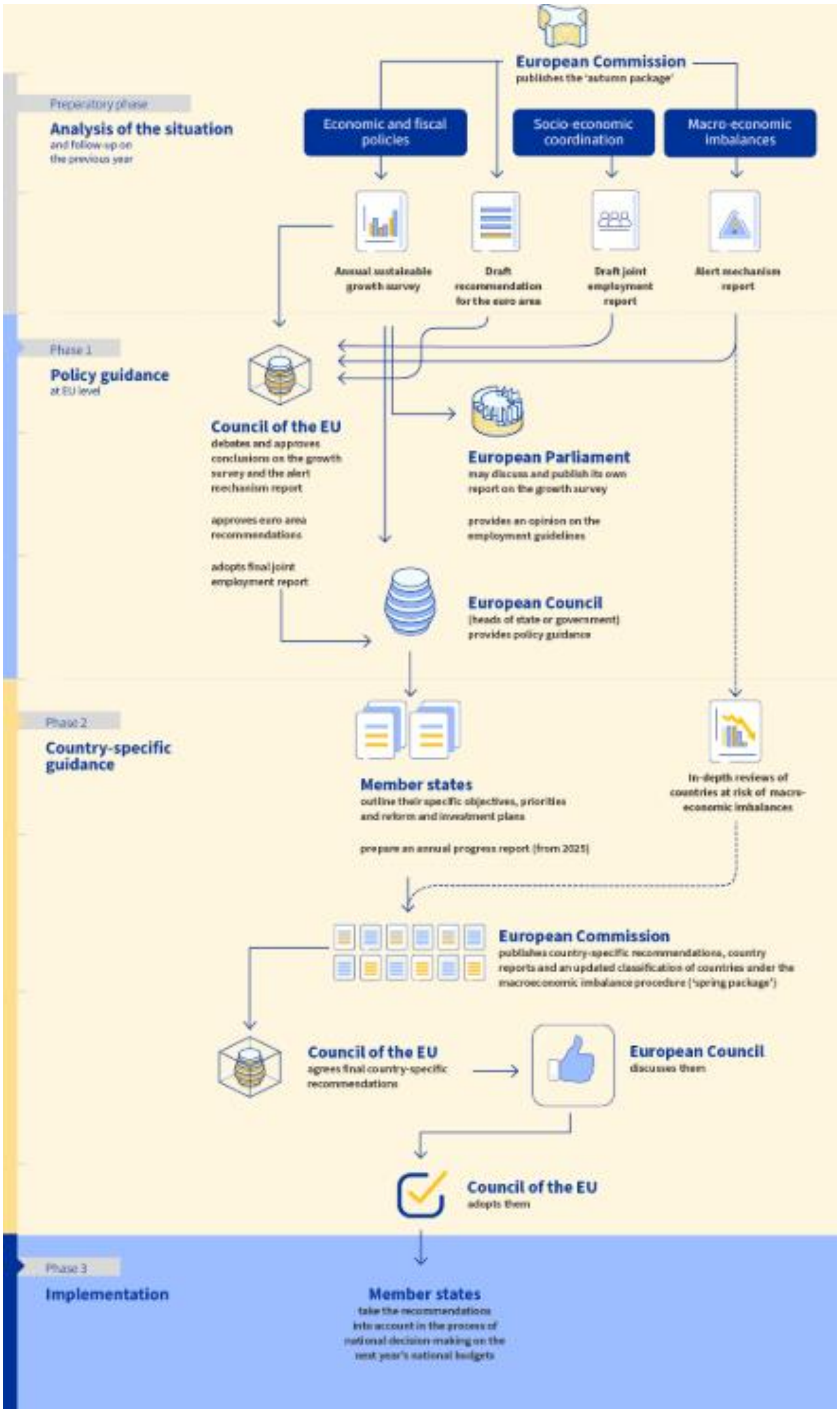
As such, the European Commission should consider developing a systematic assessment grid to evaluate the integration of climate and environmental considerations within fiscal and economic policies in Member States to ensure a consistent approach. This assessment grid can be based, for example, on the categories provided by the framework and guide of the Coalition of Finance Ministers for Climate Action[xvi]. In turn CSRs should respond to progress (or lack thereof) against this framework.

Furthermore, country Semester reports should entail a distinct section (e.g. in the Annexes) on the incorporation of climate, just transition and wider green deal dimensions within fiscal and economic policies – including, but not limited to, dimensions such as green investment mobilisation and gaps, green budgeting practices, harmful subsidies, and climate-related fiscal risks. In the same vein, tracking those dimensions within Semester reports and CSRs remains extremely complex, onerous and untransparent: the CSR database could consequently have dedicated entries ("Policy Areas" classification) for harmful subsidies and other important policy areas (e.g. green budgeting) instead of classifying those within generic policy area classifications as is currently the case (e.g. "broaden tax bases", "fiscal policy and fiscal governance" etc.).

Last but not least, the Semester process should be democratised: the choice of content in both Semester country reports and CSRs remains opaque, as there is no formal transparent process for engaging with civil society and other national actors in determining fiscal, economic policy and other policy priorities.

We consequently recommend (a) the setting of a mandatory transparent process of engagement with civil society actors ahead of the drafting of Semester reports and CSRs, to ensure that diverse views in Member States are reflected, (b) putting both country Semester reports and CSRs to public consultation in those respective Member States, whilst (c) enhancing the monitoring role of the European Parliament in the Semester process.

Annex 1: European Semester process



Source: European Commission[xvii]

Endnotes

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CONTACTS

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

JANI SAVOLAINEN: Communications Coordinator,

jani.savolainen@caneurope.org

info@caneurope.org

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