5.3 Channelling public funds away from fossil fuels

EU Member States should urgently publish plans on how and when to phase out fossil fuel subsidies

Table 33: Progress towards channelling public funds away from fossil fuels

Public climate subsidies	?
Fossil fuel subsidies	wrong direction

Past progress: Progress towards channelling public funds away from fossil fuels was going in the wrong direction in the period assessed. EU fossil fuel subsidies (FFS) have almost tripled between 2021 and 2022 and reached EUR 190 billion (OECD & IISD, 2024). For comparison, subsidies granted to renewable energy amounted to EUR 87 billion in 2022. This growth in fossil fuel subsidies is mainly due to the recent energy crisis, largely generated by the war in Ukraine, which led EU Member States (MS) to adopt more than 230 temporary subsidy measures to protect households and companies from the rise of energy prices (EC, 2022m). It should be noted that even before the energy crisis, FFS were still very high at the EU level and amounted to EUR 68 billion in 2021 already. Italy, France, the Netherlands, and Germany represented 62% of total EU fossil fuel subsidies in 2022 (OECD & IISD, 2024).

Policy context: The EU's 8th Environmental Action Programme (2022) urged MS to phase-out fossil fuel subsidies as soon as possible. This objective to end all fossil fuel subsidies by 2025 was reaffirmed by European parliamentarians at COP 28 (EP, 2023b). Following the EU's 8th Environmental Action Programme, MS are required to report their action plan to phase out fossil fuel subsidies in their National Energy and Climate Plans (NECPs) on an annual basis. According to these reports, many MS plan to move away from fossil fuel subsidies, but only a few have translated these ambitions into laws or clear plans (EC, 2023a). Denmark is the only MS that translated its objective to phase out FFS into a national plan, while Poland is the only MS that expressed an intention to continue the expansion of fossil fuel extraction.

Areas of action: To enable the redirection of financial flows from fossil assets to climate action and limit global warming to 1.5 °C, it is essential that fossil fuel subsidies are replaced by climate subsidies as soon as possible. The EC could for example impose sanctions on MS that do not publish clear plans for phasing-out fossil fuel subsidies. However, it is important to note that these plans should consider the social consequences of ending these subsidies. These sanctions could be applied first to MS that have not drawn up precise plans for phasing-out fossil fuel subsidies, and subsequently to MS that do not comply with the plans they have set themselves. It is up to the European institutions to specify the procedures and timetable for these sanctions.

A closer look at past progress

In the EU, public investments account for a significant share of the economy. Fossil fuel subsidies given by EU Member States reached 1.2% of EU GDP in 2022, which represents EUR 190 billion (OECD & IISD, 2024). This amount has tripled since 2021 (excluding inflation), even though MS are supposed to phase-out fossil fuel subsidies as soon as possible according to the EU's 8th Environmental Action Programme. While the increase in fossil fuel subsidies is partly cyclical, corresponding to governments' responses to the rise in energy prices, few MS have indicated clear dates for phasing-out fossil fuel subsidies or specified plans for doing so. The EU cannot meet its climate targets if MS continue to subsidise fossil fuels (see 4.9). Besides, fossil fuel subsidies incentivise investments in fossil fuels, thus lock in related emissions over a long period, and scarce the public finance that is needed to trigger the transition.

Fossil Fuel Subsidies

Fossil fuel subsidies (FFS) almost tripled between 2021 and 2022 and reached EUR 190 billion (OECD & IISD, 2024). This growth in fossil fuel subsidies is mainly due to the recent energy crisis, primarily generated by the war in Ukraine, which led MS to adopt more than 230 temporary subsidy measures to protect households and companies from the rise of energy prices (EC, 2023a). Almost all MS saw their total FFS increase in 2022, with the exception of Finland, Romania, Luxembourg, and Bulgaria. Italy, France, the Netherlands, and Germany represented 62% of total EU fossil fuel subsidies in 2022 (OECD & IISD, 2024).

According to a study prepared for the EC by Enerdata (EC, 2023an), 83% of EU FFS in 2022 were allocated to support energy demand, e.g., by limiting the cost of energy consumption with lower tax rates on energy products. 20% of EU FFS were allocated to households (EC, 2023an).

Italy accounted for 25% of total EU FFS in 2022 (OECD & IISD, 2024), while representing 12% of the EU's GDP and 13% of the EU population (Eurostat, 2023g, 2024h). Italian FFS more than tripled (excluding inflation) between 2021 and 2022 reaching EUR 47.6 billion – 2.4% of its national GDP (Eurostat, 2024h; OECD & IISD, 2024). Until 2021, the main forms of support were tax exemptions for diesel, kerosene, and petroleum products, with the objective to support especially freight and passenger transport, agriculture, and fisheries (EC, 2023an). In 2022, the Italian government set up several measures to contain an increase of electricity and gas prices for households and companies. The value added tax (VAT) on natural gas dropped to 5%, as did the VAT on petrol and diesel for cars. Other measures were implemented, such as a tax credit to partially compensate the extra costs due to high electricity and gas prices, the installation of a social bonus on electricity and gas for low-income households, and a discount or exemption on the general system charges on gas electricity for households and businesses (Bruegel, 2023; IEA, 2023c).

France is the second largest contributor to the rise of FFS in the EU in 2022, after Italy (in absolute value). French FFS amounted to EUR 27.7 billion in 2022 – 1.1% of France's GDP, which is three times more than in 2021 (OECD & IISD, 2024). The primary factor of this increase is the implementation of a tariff shield by the government to assist households and businesses in dealing with the escalating energy prices. In 2022, the French government allocated EUR 8 billion as a discount on fossil fuel prices for cars to households and companies. This measure was a one-off and will not be replicated in 2023. The French government also spent EUR 6.7 billion on a tariff shield on gas prices. This shield consisted of the state compensating gas distribution companies for the losses, which incurred because of the nationwide gas price freeze introduced by the state in 2021. These two measures explain 78% of the total rise in 2022 (Direction Générale du Trésor, 2023).

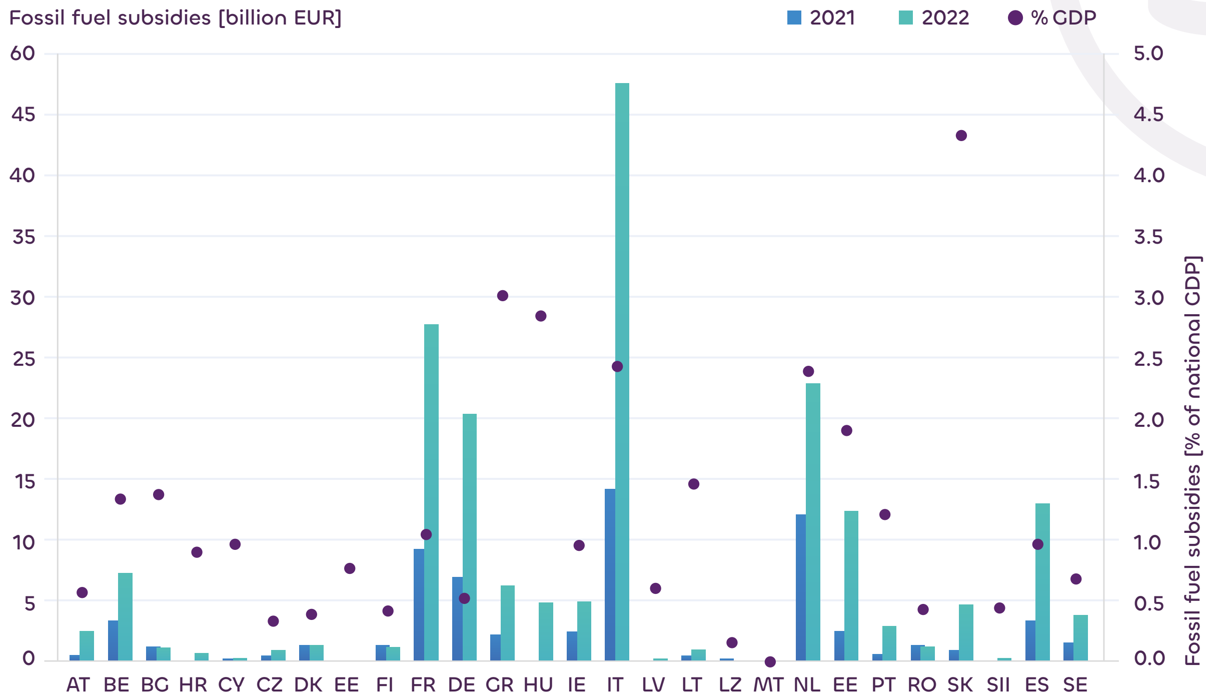
In terms of percentage of GDP, Slovakia has the highest share of FFS (4.3% of national GDP in 2022 versus 0.9% in 2021), followed by Greece (3.0% in 2022 versus 1.2% in 2021) and Hungary (2.8% in 2022 versus 0.1% in 2021). For each of these countries, the increase in FFS is also primarily due to the support measures implemented in response to the increase in energy prices (EC, 2023an). In Slovakia, the government has earmarked EUR 1.4 billion in 2022 in aid to support businesses in response to increasing energy costs and EUR 500 million to compensate electricity and gas producers for price caps. The Slovak government also spent EUR 1 billion as an anti-inflation package in 2022 to help households facing the rise in electricity and gas prices (Bruegel, 2023). In 2022, 18% of Slovakia's electricity production was generated from fossil fuels (IEA, 2024d). Therefore, some of the aid provided in response to increasing electricity costs can be considered as FFS.

In Greece, until 2021, most FFS concerned tax expenditure (foregone revenue), especially post-retirement benefits for public power corporation pensioners and employees and reduced excise taxes on diesel used for heating. In 2022, Greece introduced new or significantly expanded measures that support the consumption of heating oil, gas, diesel, and gasoline (IEA, 2023b). In May 2022, the Greek government announced a EUR 3.2 billion package to relieve pressure on household budgets and businesses from soaring energy prices. From the end of 2021 until mid-2022, the government spent EUR 2.5 billion in power and gas supply. In the winter 2022 to2023, additional aid of EUR 1.1 billion was paid to households and businesses to shield them from rising energy prices (Bruegel, 2023). In 2022, 54.4% of Greece's electricity production was generated from fossil fuels (IEA, 2024b). Therefore, a significant share of the aid provided in response to increasing electricity costs can be considered FFS.

Until 2021, Hungary had minimal FFS, accounting for only 0.1% of national GDP. However, in 2022, this increased significantly reaching EUR 4.8 billion, a 30-fold increase compared to 2021 (OECD & IISD, 2024). These subsidies primarily aimed to assist households and businesses in managing the rising costs of electricity and gas. They also included the state's response to the energy security crisis that the country was facing due to the war in Ukraine. In 2022, 33.3% of Hungary's electricity production was generated from fossil fuels (IEA, 2024c). Therefore, a non-neglectable share of the aid provided in response to increasing electricity costs can be considered as FFS. The government also implemented measures to increase domestic natural gas production to 2 billion cubic meters and to look for additional sources of gas, in order to reduce dependence on Russian gas exports (Bruegel, 2023).

It is important to note that the 2022 rise is mainly explained by the implementation of one-off measures by MS to contain the rise in energy prices for households and businesses. It remains to be seen if the total amount of FFS will return to 2021 levels or less. However, it should furthermore be noted that even before the energy crisis, FFS were very high at the EU level amounting to EUR 68 billion in 2021 already.

Figure 10: Past progress of Member States on fossil fuel subsidies



Source: OECD & IISD (2024), Eurostat (2024r).

EU and Member States policies

EU policies

As stipulated in the EU's 8th Environmental Action Programme (2022), MS should phase-out FFS as soon as possible. The objective to end all FFS by 2025 was reaffirmed by European parliamentarians at COP 28 (EP, 2023b). As the amount of FFS in the EU tripled between 2021 and 2022, it is now more important than ever for the EU to push for a swift return to and action on those commitments.

More specifically, the EU urged MS to phase-out FFS at the Union, national, regional, and local level without delay, setting a deadline and imposing a binding framework to monitor and report on their progress (EU's 8th Environmental Action Programme) in their NECPs. These reports outline that almost all MS plan to phase-out FFS, except for Poland that has plans to expand fossil fuel availability and use. Bulgaria and the Czech Republic do not mention any FFS phase-out. Several countries, such as France, Germany, Italy, Latvia, Lithuania, and Luxembourg publicly reconfirmed their commitment to an economy-wide phase-out of FFS. The power sector is the sector where MS have the most concrete plans to phase-out their FFS, especially for coal. Eight MS have also set dates to phase-out FFS in the building sector. However, for the other economic sectors, such as industry, transport, and agriculture, an end-date of FFS is completely absent.

The EC urged MS to provide more transparency on end-dates for FFS. According to the Commission, the absence of information on end dates for these subsidies makes it difficult to assess whether the EU is **on track** regarding its climate objectives (EC, 2023a).

Finally, the Energy Taxation Directive (2003) still allows fossil fuel subsidies through tax exemptions for certain sectors, in particular for commercial shipping, aviation, and the fisheries sectors. This text is currently being revised by the European institutions, with the possibility of ending these exemptions.

Member States policies

Among MS, **Denmark** is the only country that has set out a comprehensive national plan to concretely phase-out all FFS. In 2022, the Danish government presented its political framework for phasing-out fossil fuel subsidies and establishing a new Green Fund (EC, 2023h). As part of this, Denmark committed itself to completely phase-out FFS related to electricity generation and coal-fired power plants, as well as support in fossil heating systems in the building sector (EC, 2023an). Denmark is one of the countries with the best practice so far, even if more transparency on the FFS end date is still needed. However, Denmark only represents 0.8% of total EU FFS, amounting to a total of EUR 1.6 billion in 2022 (OECD & IISD, 2024).

France committed itself to end all FFS but without setting a date to do so. As reported in its last NECP update, France is planning to phase-out 60% of its FFS by 2025 (EC, 2023an). More specifically, France plans to eliminate the tax gap between the reduced tariff and the normal tariff for petroleum products (excluding natural gas and coal) consumed by energy-intensive businesses, and coal consumed by energy-intensive businesses exposed to international competition by 2024. It also plans to eliminate the tax gap for non-road diesel between 2024 and 2030 and for diesel used by agricultural machinery by 2030. In addition, the French government committed itself to reduced excise tariffs on coal used by energy-intensive installations, as well as to an alignment of the standard jet fuel tariff and the excise tariff for aviation petrol with the tariff applicable to road petrol in 2024. However, France did not commit to an end date for FFS in the buildings, transport, and agriculture sectors (EC, 2023p). France represented 15% of total EU FFS in 2022, amounting to a total of EUR 29.2 billion (OECD & IISD, 2024).

Germany also committed to ending all FFS but without setting a date to do so. As reported in its last NECP update, Germany is planning to phase-out 50% of its FFS by 2025 (EC, 2023an). Germany plans to end subsidies for early retirement of outgoing coal workers (adaptation allowance) that will expire at the end of 2027. Post-decommissioning activities were subsidised up to and including 2022 (EC, 2023q). Germany also indicated an end date for FFS in the buildings sector, but not for the transport and agriculture sectors (EC, 2023an). Germany represented 11% of total EU FFS in 2022, amounting to a total of EUR 21.4 billion (OECD & IISD, 2024).

Unlike Denmark, France, Germany and other MS, **Poland** has not committed to phasing-out FFS at all. Poland is also the only country that has not given any consideration on phasing-out coal-based electricity. The government has an agreement with the Polish Mining Company to maintain hard coal mining operations until 2049. The Polish government expressed the objective to expand the availability of fossil fuels and diversity of its supply through the development of new infrastructure for natural gas, LNG, and oil (EC, 2023an). Poland can thus be considered one of the worst performers regarding plans to phase-out FFS. Poland represents 7% of total EU FFS (while representing 4% of the EU's GDP), amounting to a total of EUR 12.5 billion in 2022 (OECD & IISD, 2024).

Areas of action

To enable the redirection of financial flows from fossil assets to climate neutral ones and limit global warming to 1.5°C, it is essential that fossil fuel subsidies are replaced by climate subsidies as soon as possible.

As stipulated in the EU 8th Environmental Action Programme (2022), MS should provide a 'binding Union framework to monitor and report on Member States' progress towards phasing out fossil fuel subsidies, based on an agreed methodology' and set 'a deadline for the phasing out of fossil fuel subsidies'. These MS plans should appear in their NECPs. Most of the MS expressed their intention to move away from fossil fuel subsidies but did not necessarily translate this intention into concrete plans with clear end dates (EC, 2023a).

If the European institutions want the Environmental Action Programme to be effective regarding the FFS phase-out, e.g., they could impose sanctions on MS that do not publish clear plans, including end date, for phasing-out all FFS. These plans should include clear end dates for FFS in all relevant sectors, not only for FFS given to coal-fired power plants, but also for all electricity generation based on fossil fuels (including natural gas), as well as for the industry, the transport sector, the heating systems of buildings, and the agriculture sector.

These sanctions could be applied first to MS that have not drawn up any precise plans for phasing-out fossil fuel subsidies, and subsequently to MS that do not comply with the plans they have set themselves. It is up to the European institutions to specify the procedures and timetable for these sanctions. However, it is important to note that these plans should take into account the social consequences of ending these subsidies.

The EU should also revise its Energy Taxation Directive to exclude the tax exemptions for fossil fuels in the aviation and maritime sectors.