

Governance of the EU-Wide Phase-Out of Fossil Fuel Subsidies by 2020

Remove subsidies for fossil fuel consumption

Remove subsidies for fossil fuel production

Support a just transition for workers

FEATURED COUNTRIES



EUROPEAN UNION (28 MEMBER STATES AT THE TIME OF WRITING)

- High-income and upper-middle-income countries in and outside the Organisation for Economic Co-operation and Development (OECD)
- All countries are net energy importers

Key numbers

EUR 112 billion in the EU

This was the annual average value of all forms of government support (fiscal support, public finance and state-owned enterprise investment) to production and consumption of oil, gas and coal between 2014 and 2016 (Gençsü et al., 2017).

FEATURED REFORMS AND THEIR PERIOD

- EU phase-out of subsidies to hard coal mining (by 2018)
- Wider full EU phase-out of subsidies to production and consumption of fossil fuels by 2020

STAGES OF FOSSIL FUEL LIFE CYCLE

- Exploration – Development – Extraction – Transportation and Transmission – Distribution – Refining and Electricity Generation – Consumption

SECTORS AFFECTED BY REFORM

- Coal mining, oil and gas production, power production, transport, industry, households and agriculture

Context

The European Commission has repeatedly called upon member states to phase out environmentally harmful subsidies by 2020, including those for fossil fuels; EU member states are obliged by law to remove subsidies to hard coal mining by 2018 (Council of the European Union, 2011; European Commission, 2011).

At the international level, the EU has also: committed to phasing out inefficient fossil fuel subsidies by 2025 through the G7 (G7, 2017); reiterated its commitment to phasing out inefficient fossil fuel subsidies every year since 2009, as part of the G20 (G20, 2018); and included a reference to a shared goal of “progressively reducing subsidies for fossil fuels” in the text of the EU–Singapore Free Trade Agreement (awaiting final approval) (European Commission, 2015).

Drivers of reform

The *Third Report on the State of the Energy Union* states explicitly that: “The clean energy transition may be hindered by unfair competition if Member States continue to provide fossil fuel subsidies. These come in many forms, such as direct subsidies to uneconomical coal mines, capacity mechanisms for emission intensive power plants, tax relief for company cars or diesel fuel and similar measures. Fossil fuel subsidies also increase the risk of investing in stranded assets, which need to be replaced before the end of their lifetime” (European Commission, 2017b).

In the case of the more near-term phase-out of subsidies to hard coal mining, this has also been driven by the fact that it has become increasingly uneconomical over time, in part due to the falling costs of alternatives for power production (gas and renewable energy) (Gençsü et al., 2017).

Change in the mechanisms of government support to fossil fuels

AT THE EU LEVEL

In January 2018 the European Parliament voted in favour of reporting on progress towards fossil fuel subsidy phase-out. Three measures have been included in the European Parliament’s position on the Energy Union Governance Regulation.

- First, the position cites that the *State of the Energy Union* report shall contain member states’ progress toward phasing out direct and indirect fossil fuel subsidies by 2020.
- Second, EU member states should also be required to include plans for national policies, timelines and measures to phase out direct and indirect fossil fuel subsidies by 2020 in their National Energy and Climate Plans (NECPs). Member states will have to submit these plans in 2018, and they need to be final by the end of 2019.
- Third, the next report on energy prices and costs in 2018 will provide updates on fossil fuel subsidies in the EU.

In addition, for the first time, the Cohesion Policy proposal in the EU budget contains a list that would exclude European Regional Development funding for investments related to production, processing, distribution and storage of combustion of fossil fuels (except for investment related to clean vehicles).

It is anticipated that the integrated national energy and climate plans should help to better monitor and assess member states’ efforts to reduce and eventually phase out fossil fuels subsidies (European Commission, 2017).

AT THE EU MEMBER STATE LEVEL

A subset of member states responded directly to these commitments at the EU level. The same month, the Dutch parliament adopted a resolution requesting that the government include efforts to gradually phase out fiscal incentives that undermine the Dutch climate goals in its National Energy and Climate Plan, and to participate in the G20 fossil fuel subsidies peer review process (Tweede Kamer, 2018). French President Emmanuel Macron also acknowledged the EU budget's climate action potential, committing to dedicating 40 per cent to green investments and to put an end to fossil fuel subsidies (Climate Action Network Europe, 2018).

Prior to these commitments, there had already been some progress in ending fossil fuel subsidies across the EU, including:

- The EU significantly reduced its own fiscal (budgetary) support to fossil fuels, with only EUR 515 million provided per year for oil and gas production in the EU budget between 2014 and 2016 (Gençsü et al., 2017).
- The Netherlands ended differentiated tax rates for diesel in 2013, and France has taken steps to shrink the taxation gap between diesel and petrol by 2021.
- Many European governments have committed to ending international public finance and export credits for coal-fired power and coal mining.
- Sweden's majority state-owned energy company, Vattenfall, has drastically reduced its financing for coal-fired power in recent years, which has led to the company's coal-fired power generation declining by more than half between 2014 and 2016.

Processes for tackling subsidies within the EU have also broadened the framing for identification of instruments for phase out, with European Commission reports referencing government support through market mechanisms such as the EU Emissions Trading Scheme (EU ETS) and capacity mechanisms.

Complementary policies

In 2010, the EU took a significant step toward ending hard coal mining subsidies by adopting a Council Decision that prescribes their phase-out by the end of 2018. One of the key examples of complementary measures in the EU has been linked to this subsidy reform process, as member states can provide closure aid until 2018 to cover the current production losses in the context of the definitive closure of uncompetitive coal mines. By the end of this year, uncompetitive mines will have to shut down or else they will return the aid they have received thus far (Tamma, 2018).

In many countries, the scale of this support has been significant. Combined aid in the German state of North Rhine Westphalia alone to support the sale of coal from hard coal mines to electricity and steel producers has an estimated annual cost of EUR 1.86 billion, with the German government spending an estimated EUR 18.6 billion on this measure between 2005 and 2014 (Whitley et al., 2017).

Did the reform generate fiscal or financial space? How was it used?

Many countries are successfully phasing out support to coal mining, and a significant proportion of the remaining fiscal support to coal is focused on the transition away from coal (see complementary policies below). It is notable that the majority (between 75 and 99 per cent) of fiscal support provided to coal mining in the Czech Republic, Germany and Spain was directed toward a just transition for workers and communities and the decommissioning and rehabilitation of mining sites (Gençsü et al., 2017).

Although the phase-out of government support to coal mining was agreed in 2010, it was only in 2017 that the European Commission agreed to revise its Emissions Trading System Directive to allow for some of the funds raised by the auction or sale of emissions certificates to be used for just transition measures and that it established a Coal Regions in Transition Platform (IndustryAll, 2017; European Commission, 2017a).

Wider benefits of the reform

Support to coal, oil and gas by European governments and institutions continues (EUR 112 billion per year between 2014 and 2016), even though the phase-out of these subsidies is widely agreed to be critical for the energy transition, to ensure financial and economic sustainability, to fight air pollution and to achieve climate targets. Tracking these subsidies to support their phase-out presents an opportunity for Europe to demonstrate leadership both at home and abroad.

The EU can play this key leadership role on ending subsidies within the G7 and the G20 and through ending public finance for fossil fuels, including by ensuring that bilateral, European and international institutions funded by European governments (i.e., multilateral development banks) eliminate existing support to fossil fuels and monitor reforms.

Watching brief

The scale and duration of support to the transition away from coal mining in Europe (and in Germany thus far in particular) begs the question of whether these government resources have been used in the best possible way to support a just transition away from coal, instead of propping up an uneconomical and high-carbon industry. It also raises the question of what the balance of responsibilities should be in terms of shutting down coal mines and to what extent companies should set aside resources to cover these costs (Whitley et al., 2017). As all EU member states are supposed to phase out aid to hard coal mines by the end of 2018—and as the European Commission has called for an end to environmentally harmful subsidies by 2020—it will be important to draw lessons from the German experience. This will be critical, not only to manage the ongoing transition away from coal mining, but also in the move away from coal power production (Whitley et al., 2017).

In terms of the wider fossil fuel subsidy phase-out, there is also a real risk that the EU and its member states increase transparency around the scope and scale of subsidies and make strong phase-out commitments in their national energy and climate plans, while failing to act to end government support to oil, gas and coal. This is highlighted in Germany's participation in the G20 peer review of fossil fuel subsidies, which has the objective of increasing transparency on fossil fuel subsidies and identifying those that should be eliminated. Despite OECD data showing that Germany had 23 subsidies to fossil fuel consumption and production worth EUR 3.9 billion overall in 2016, Germany stated in its peer review that it had only two “inefficient” subsidies that need to be removed. The government had already committed to ending both of these under the EU agreement to end subsidies to hard coal mining by 2018 (Overseas Development Institute, 2017).

EU governments may promote fossil fuel subsidy reform as a tool critical to achieving the Paris goals while refusing to fully acknowledge all support for oil, gas and coal. They may look to eliminate a handful of support measures while denying the cost of subsidies they continue to provide to activities that include diesel transport, coal-fired power, and oil and gas production overseas.

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