Europe's Green Policy Maze

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The EU's Green Deal singularly focused on rapid and drastic decarbonization in Europe. This focus is now fully backfiring, leading to grotesque contradictions in policy proposals.

Driven by the **European Green Deal**, launched at the end of 2019, the burden of green policies has greatly increased across Europe in the last few years. The **EU's Emission Trading System (ETS)**, for instance, was established in 2005 and, to some extent, accommodated industry requests for transition time by allocating free emission rights to avoid carbon leakage, maintaining a large reserve of rights, and allowing for a gradual tightening of the total amount of rights. However, under the auspices of **Frans Timmermans**, the former executive vice president of the **European Commission**, the screws were tightened on all three factors. These changes are now potentially backfiring, as some member states, such as **Italy**, question the necessity of the entire system.

Along with the tightening of the **ETS** came a plethora of new initiatives and the intensification of existing ones, such as **CBAM**, **ETS2**, **ESR**, **RED**, **CSRD**, **EU Taxonomy**, **Just Transition Mechanism**, etc. The **Commission** outlined the green transition in plans and implemented them through regulations, reporting requirements, and enforcement mechanisms. A fundamental characteristic of the entire exercise was the top-down selection of technologies. In this top-down approach, there was no place for nuclear energy, despite the fact that nuclear energy leads to zero carbon emissions.

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The **Green Deal** revolution created a dynamic in which energy efficiency goals were transformed into energy reduction goals, leading member states to focus on curtailing energy-intensive activities rather than stimulating new projects to generate energy for the future. This approach produces unintended and counterproductive consequences, as seen, for example, with data centers. They are essential infrastructure for the **AI** revolution, but the **European Commission** will only allow them if they "do not use too much energy or water."

Whatever one thinks of AI—and precautions must be taken—not joining this revolution is not only unrealistic (others will impose it on us) but also blocks a major avenue leading to much-needed economic growth. **Oxford Professor Sir Dieter Helm** argues in a recent book, ***Climate Realism: Facing the Facts About Energy***, that we will need more energy to sustain and improve economic growth prospects. The **Degrowth movement**, which received much critique in academia and popular opinion, is being put into practice in Europe through its energy policies.

Utterly Absurd

The transition towards greener and more sustainable policies, both at EU and Member State level, has inevitably impacted energy prices. As far as the progressive agenda was concerned—"going green and doing good"—high fossil fuel prices were expected to make people more conscious of their energy consumption and incentivize them to reduce it.

Now that wars are raging through the **Middle East**, fossil fuel prices have again shot up. Yet suddenly, the very same increases in fossil fuel prices are considered entirely unacceptable by those same political groups, prompting calls for immediate relief

measures and state intervention to protect households from precisely the price signals that were previously seen as instrumental in achieving the desired behavioral change. One can, of course, regret that some of the price hikes are now due to the situation in the Middle East instead of our own policies, but it remains rather counterintuitive to cheer for high energy prices in one case but not in other cases. The erosion of people's purchasing power as a consequence of higher energy prices is the same, whatever the source of the price rises.

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Because of conflicting ideas in the analysis, confusion also reigns in the proposed solutions. The policy proposal that has made the most sense for years is to phase out all subsidies going to fossil fuel companies, but claims around their magnitude have been exaggerated. The **European Commission** estimates fossil fuel subsidies in the EU to be 97 billion euros in 2024. Moreover, a detailed examination of these subsidies reveals that half are, in fact, tax reductions, which largely subsidize those who consume fossil fuels. Removing these "subsidies" would automatically lead to price increases that would then again fuel demand for government intervention to... reduce the burden of these price increases on consumers. In terms of inconsistent policies, it is hard to become more absurd than this.

Moreover, the taxes retrieved from fossil fuel subsidies are estimated to be several times larger. Nowadays, many argue for consumer support programs to help them pay their energy bills. This is again a bit of a contradiction, as tax elasticities would mean that part of that support will go to energy companies.

Another proposal that garners a lot of support is the **windfall tax on profits**, or the taxation of excess profits of energy companies. First of all, there is a crucial issue with the definition of windfall profits. The essential element in entrepreneurship is uncertainty and

risk. Good years need to make up for bad years. The potential negative effects of windfall taxation become clear when you think it through. What to do, for instance, with a fossil fuel company that diversified into green energy activities that profits greatly from the difficulties of fossil fuel sourcing?

The windfall tax also ignores the economic function of profits. The price system works by increasing prices and profits where resources are scarce. That incentivizes people to look for alternatives to relieve the scarcity. If the price signal is subdued and the search for alternatives stalls, government policies can, in the end, increase prices in the longer run with a windfall profit tax as a consequence. It is unclear which effect will prevail, and one can thus definitely raise the question of whether windfall profit taxes are not entirely counterproductive. Last but not least, there is again a contradiction through tax elasticities. When the government taxes energy companies, these companies will partially pass on the taxes to their customers, thereby further raising energy prices for people.

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Another Way Forward

Sometimes the position is defended that the war in the **Middle East**, together with the EU's dependence on **Russian** fuels, shows that the green policy agenda was entirely right and that we should double down to speed up the energy transition. This argument conveniently disregards some other elements. First, a new dependence has been building up in the renewable sector, where **China** is now the de facto world leader in several stages of renewable energy production, including the essential rare earths. Of course, every technology nowadays comes with its dependencies, but that calls for a good mix,

certainly when an increasingly anti-Western power like China is involved. Second, the green policy agenda has made it very difficult to continue certain fossil fuel activities within Europe, increasing our dependence on third countries. Third, the broader industry is also having trouble staying viable in Europe as a consequence of the **Green Deal**-induced policies.

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Perhaps the most logical conclusion is then to rethink parts of the regulatory and taxation framework. If you know, for instance, that taxes and levies increase the electricity bill of households by approximately 50% in the EU, there is a lot of leeway to lower the energy price burden. Governments have also made it a Herculean task to keep investing in fossil fuel activities in the Union itself, of which the **Groningen** gas fields, which we discussed in a recent blog, is the most glaring example. We have to confront the reality that we need time to lower our dependence on fossil fuels. We need time to invest more in green nuclear energy, in investigating the potential of **Small Modular Reactors**, perhaps of nuclear fusion technologies. We need time to adapt our grids to the variability of solar and wind technologies, to allow for further efficiency gains, and to enhance battery capacities. We need time for electrification and to take feasibility concerns in certain parts of industry seriously. We need time for unexpected innovations and the new challenges they will bring.