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Non-paper by the Netherlands

Policy reflections on the upcoming EU framework on fossil fuel subsidy phase-out

The Netherlands welcomes the incoming EU Commission's intention, outlined in the Mission Letters, to propose a framework on fossil fuel subsidy phase-out that reduces Europe's strategic dependencies. Decarbonisation of energy systems goes hand in hand with bolstering the competitiveness and overall resilience of the EU. Furthermore, reducing reliance on fossil fuels can contribute to reducing exposure to volatility in the energy markets and allowing for the benefits of the energy transition to be transferred to end users, as acknowledged in the Draghi report on long-term EU competitiveness.

In order to contribute to an effective and efficient transition towards climate neutrality, resilience, and competitiveness for Europe, the new framework should incorporate three main building blocks:

1. **Transparent and consistent inventories for accurately scoping fossil fuel subsidies:** To further increase the reliability of the annual inventory of fossil fuel subsidies in the EU-27, the Commission can issue recommendations to promote reporting consistency and explore conditionalities to encourage member states to deliver on agreed reporting expectations. Furthermore, the Commission should examine the extent of fossil fuel subsidies in the current Multi-Annual Financial Framework. The Netherlands recommends that the Commission and other Member States deploy an assessment approach that is inclusive of both the direct and indirect environmental tariffs and subsidies (such as financial support measures and exemptions, discounts and free emission allowances).[1]

2. **Leveling the playing field, while incentivising continued clean technology uptake**: It is critical that the framework includes both robust pricing incentives and targeted regulation, balanced in a way that minimizes unintended side-effects. To this end, remaining exemptions in EU taxation and carbon pricing frameworks should be critically reviewed. Clear and reliable incentives are critical for a two-tier approach, which both accelerates a fossil fuel subsidy phase-out and effectively removes remaining barriers to clean technology uptake. This includes scoping the need for investment for sustainable alternatives and targeted measures in markets that are insufficiently mature, such as the transition to sustainable carbon in the chemical sector. Any fiscal space that opens up with subsidy reform, provides an opportunity to leverage for the transition.

3. **Reinforcing international momentum towards fossil fuel subsidy phase-out**: At the EU level, concerted efforts are necessary to both protect the level playing field and encourage further action outside of EU territories. For instance, efforts to strengthen the ETS should be complemented by WTO-compliant market-based mechanisms to avoid external carbon leakage. The *Coalition to Phase-out FF Incentives including Subsidies* (COFFIS), which was launched by the Netherlands at COP28 and is currently supported by nine EU member states, is indicative of impact of international collaboration. EU wide efforts could also build on international initiatives such as the OECD mapping exercise of net effective carbon rates, joint OECD/IEA work in this area, and the *Coalition of Finance Ministers for Climate Action*.

The Netherlands further calls on the European Commission to take the following actions:

- Pursuing strengthened pricing incentives under the **Emissions Trading System** as a cornerstone of EU climate policy. To this end, the Commission should leverage the upcoming review of the ETS-Directive, expected in 2026. Based on a critical review of remaining exemptions, there is an opportunity to remedy the underpricing of fossil-fuel activities, while protecting the level playing field.
- Bolstering the **National Energy and Climate Plans** as an effective policy coordination tool. In encouraging reporting by all member states, the Commission can explore if the quality of national

[1] Current methods to measure fossil fuel subsidies used by the European Commission may underestimate the scope of fossil fuel subsidies. To illustrate this, the national inventory of the Netherlands estimated fossil subsidies at €39,7 - 46,4 billion (Ministry of Finance, 2023), in contrast to €123 billion for the EU-27 (2022 figures) based on an annual analysis by DG ENER on energy subsidies and related instruments: [Study on energy subsidies and other government interventions in the European Union - Publications Office of the EU (europa.eu)](europa.eu).

reporting may be factored in the eligibility for specific EU funds for the clean transition. The Commission can also issue recommendations to member states on their national trajectory for fossil fuel subsidy reform, including a deadline for phase-out.[2]

- Leveraging the **European Semester** to mitigate price stability risks associated with reliance on fossil fuels from outside of the EU. The Commission issued recommendations in 2022 and 2023 to all member states to reduce these strategic dependencies, where the EU Recovery and Resilience Facility became a central tool to deliver on strategic EU policy priorities in the European Semester.[3] The Commission should address this matter in more depth in future Country Specific Recommendations and may consider similar conditionalities going forward.
- Ensuring EU **state aid policy** remains fit for purpose by protecting market incentives for energy efficiency and renewable energy investments including clean heating solutions. Due to bold policy initiatives in the European Union to shield EU consumers from energy price shocks fossil fuel subsidies in the EU-27 more than doubled in 2022, reversing a long downward trend.[4] The Draghi report estimated that large-scale investments direct income support and infrastructure for importing LNG have cost the EU over a year's worth of GDP. Temporary crisis relief measures should be discontinued immediately when these are no longer justified in order to avoid long-term negative economic impacts. Remaining measures, including for natural gas fired combined heat and power systems, should be critically reviewed.

[2] Such a trajectory could provide strong market signals needed to inform investment decisions. The EU already committed to align with such a deadline in the decision on the 8th Environmental Action Programme (article 3 (h) (i) of Decision 2022/591). This commitment was reiterated in the Environment Council Conclusions of 17 June 2024. Furthermore, the European Scientific Advisory Board on Climate Change recommended that Member States should fully and urgently phase out fossil fuel subsidies, including by setting a deadline and by detailing a clear plan and timeline in their updated NECPs.

[3] Questions and answers on the 2023 European Semester Spring Package.

[4] European Commission (2023). Report on Energy Subsidies in the EU.