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Monthly Analysis

How Feasible is the Abolition of Energy Subsidies in SE Europe?

Introduction

Energy subsidies and government interventions refer to specific initiatives to keep prices for consumers below market levels (e.g. reduced tax rates on road transport fuels) or for producers above market levels (e.g. feed-in tariffs), or to reduce costs for consumers or producers by granting specific benefits. Energy subsidies may be made by means of direct cash transfers to producers or consumers, as well as indirect support mechanisms (e.g. tax exemptions and tax credits), or even market-based mechanisms providing cross-subsidies between economics actors (e.g. white certificate markets for energy efficiency, electricity capacity mechanisms).

This Monthly Analysis tries to shed light on the latest developments in terms of energy subsidies in both Europe and SE Europe, highlighting an overview of the different policies used by countries at national level to mitigate the effect of the price spike for consumers and how feasible is to abolish them shortly.

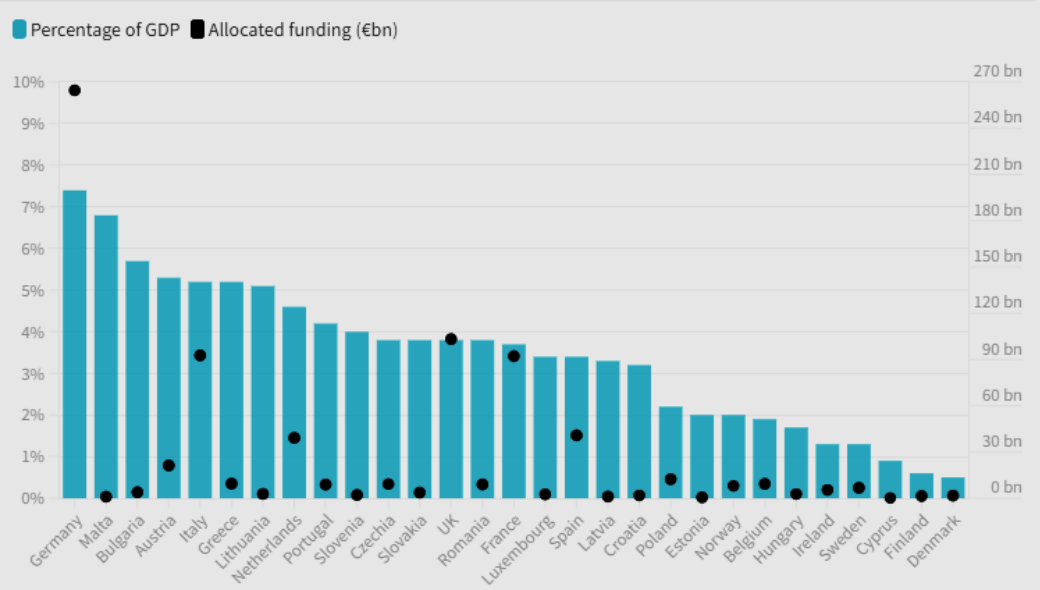
Energy Subsidies in Europe

Since the start of the energy crisis in September 2021, €758 billion has been allocated and earmarked across European countries to shield consumers from the rising energy costs. Based on Bruegel's data **(1)**, the breakdown is the following:

- €646 billion in the EU, of which €265 billion has been earmarked by Germany alone
- €103 billion in the UK
- €8.1 billion in Norway

While policies at regional level can have a sizeable impact on consumers, for example in Belgium, in most European Union countries both energy regulation and levies are set at national level. Similarly, long-term measures to counteract energy-price volatility are also of extreme importance. Figure 1 shows the funding allocated in the period September 2021 to January 2023 by selected EU countries to shield households and businesses from the rising energy prices and their consequences on the cost of living. Figure 2 displays total support to households and firms on a per capita basis, while Figure 3 represents how much governments have allocated to support utilities in meeting their liquidity needs - through loans, bailouts and in some cases fully fledged nationalizations.

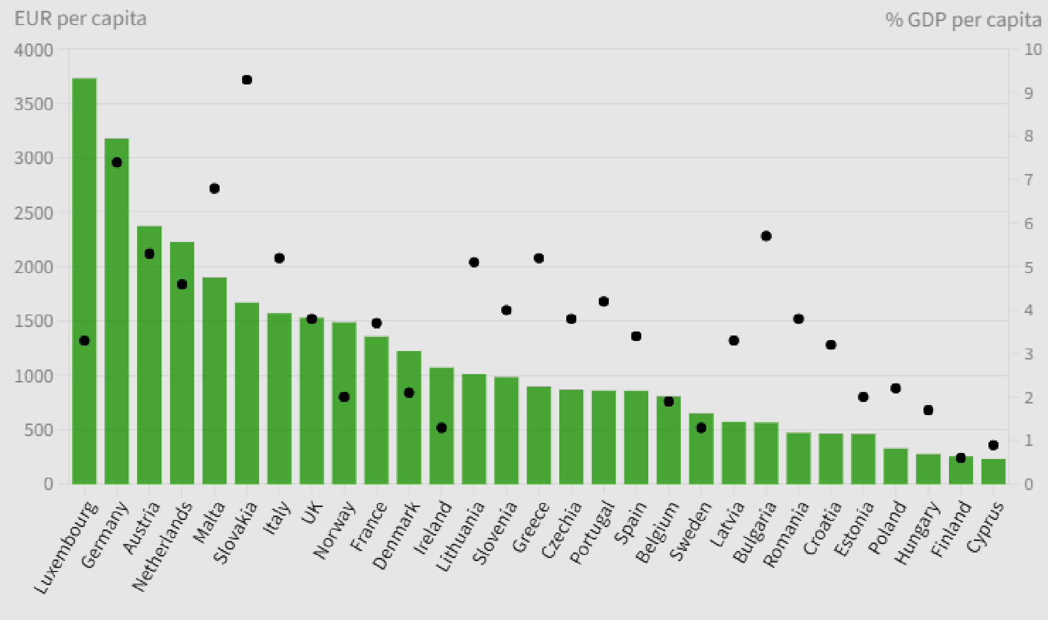
Figure 1: Governments Earmarked and Allocated Funding to Shield Households and Firms from the Energy Crisis, % GDP, September 2021 – January 2023



Source: please refer to the methodological note in excel for a break-down of the packages and the sources in details.
Note: We include only measures that are provisional and motivated by the energy crisis while we exclude pre-existing ones. Estimated numbers also include funding earnmaked but not yet allocated. The GDP used for the graph above was retrived from Eurostat in date 21.04.2022 and refers to the year 2021. Following the recent decrease in natural gas prices, governments have revised the budget earmarked for measures to shield households and firms from the energy crisis, and we have revised the figures for Slovakia accordingly.

Source: Bruegel

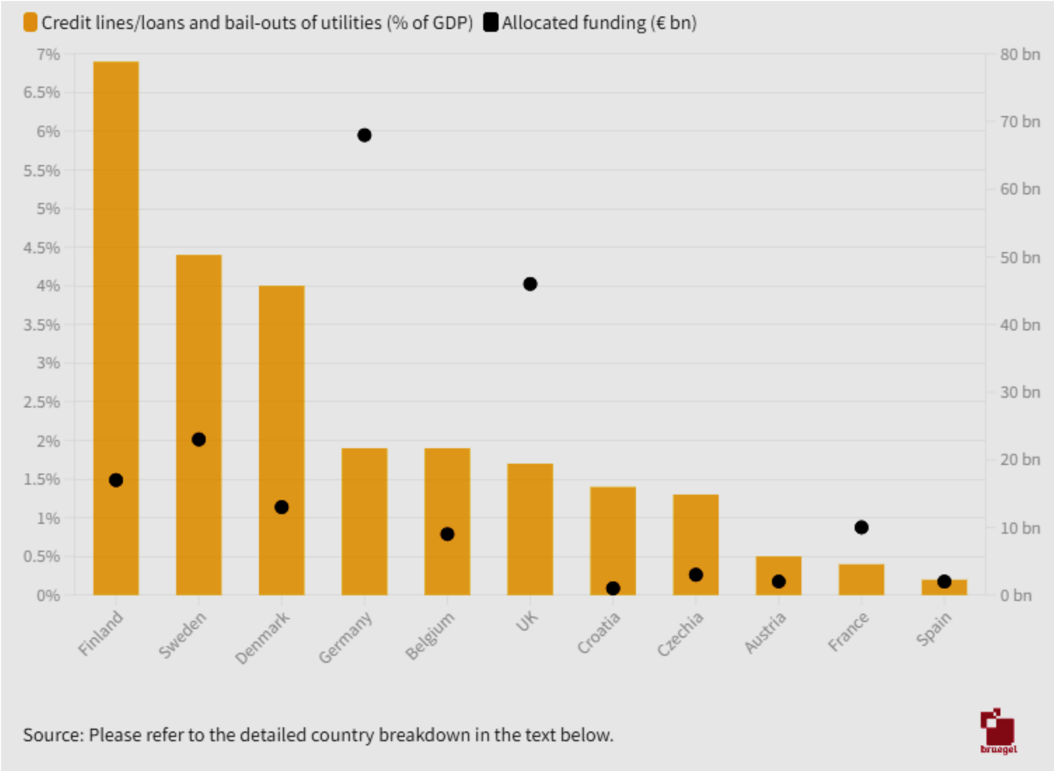
Figure 2: Governments Earmarked and Allocated Funding to Shield Households and Firms from the Energy Crisis, % GDP per Capita, September 2021 – January 2023



Source: Bruegel. • Note: Please refer to the methodological note in PDF for a break-down of the packages and the sources.

Source: Bruegel

Figure 3: Governments Earmarked and Allocated Funding to Meet Liquidity Needs of Utilities, % GDP, September 2021 – January 2023



Source: Bruegel

It is estimated that governments spent 1.2% of EU gross domestic product in 2022 on energy subsidies and plan to spend 0.9% in 2023. But the European Commission recently announced that the measures should now be unwound as the cost of energy drops and deficits need to be reduced. "As energy prices head lower, we should move to phasing out most of the support measures, starting with the least targeted", said Valdis Dombrovskis, executive vice-president at the European Commission. "The time for broad-based fiscal support has passed. It is time to shift gear and look to the future. From a fiscal standpoint, we need to change focus". **(2)**

Dombrovskis said if support had been given to only the poorest 40% of citizens in 2022, the cost would have been cut by three-quarters. Many analysts argue that the subsidies in most countries disproportionately benefited the wealthy, who consume more. "The measures were not very well targeted and did little to reduce consumption", he said. The Commission confirmed that the general escape clause, which suspended enforcement of the Stability and Growth Pact, would be "deactivated" at the end of 2023. Under the pact, countries are meant to limit budget deficits to 3% of GDP and bring debt ratios to 60% of GDP or below. "That means that from 2024 Brussels is likely once again to open so-called excessive deficit procedures against member states where the gap between public revenue and spending is overshooting the target", said Paolo Gentiloni, Economics Commissioner. **(3)**

Energy Subsidies in SE Europe

Energy subsidies were also provided in several SE European countries. A country-by-country analysis, mainly for the EU member states in SE Europe, follows. We should note that in order to avoid repetition we made reference only to indicative policy measures.

Bulgaria

On October 22, 2021, the Bulgarian government announced an instrument to compensate companies with €55/MWh for two months. The €225 million required for the subsidies came from windfall profit tax on the nuclear power plant Kozloduy. **(4)**

At the end of December 2021, the Bulgarian Minister of Energy Alexander Nikolov announced a new measure, compensating businesses for 75% of the electricity price increase above a threshold of €95/MWh but not more than 30% of the actual average monthly price (the actual price then went to €219/MWh, the 30% ceiling was activated and the compensation was about €66/MWh). The minister said at the time that the compensation for the high electricity prices would exceed €460 million for the four months, with the state budget covering most of the cost. On January 20, 2022, the formula was amended and maximum compensation, while staying put at 75% of the bill above €95/MWh, was brought to €128/MWh.

On February 10, 2022, the parliament passed a new budget with a package to mitigate the economic consequences of the surge in electricity and gas prices, for which it would spend €476 million to support businesses. On May 16, 2022, Bulgaria passed a series of aid packages amounting to €1.1 billion targeted at the price of petrol and rising energy prices for consumers. It would fully compensate businesses for the 14% increase in gas prices. It also froze energy prices for households using July 2021 as a threshold. The Bulgarian government hence covered 80% of electricity prices above €102/MWh for business. It discounted the price of petrol by 13 cents per liter from July 2022 until the end of the year for households, and scrapped excise duties on natural gas, electricity and methane.

On July 28, 2022, at its last Council of Ministers, PM Kiril Petkov announced three energy measures among which the new program for compensating businesses for the price of electricity, starting from July 1, 2022 to September 30, 2022. The cabinet also allocated €77 million for reducing fuel excises. On September 30, 2022, the government announced that it would allocate an additional €1.85 billion to extend the support mechanism for businesses. The target group comprised 633,000 commercial consumers for which €1.6 billion was targeted, while the rest went to network operators.

On November 8, 2022, the parliament reportedly adopted a decision to extend existing compensations to mitigate the effects of high electricity costs for businesses until the end of 2023. All non-household consumers are fully compensated for the difference between the real average monthly base load price of the day-ahead market of the Bulgarian Independent Electricity Exchange (IBEX) for the relevant month and the base price of €128/MWh. The Parliament also decided to implement a compensation base price of €102/MWh for large industrial consumers, if they invest in energy efficiency improvements and the development of renewable energy sources for their own use. **(5)**

Croatia

On February 16, 2022, Croatian Prime Minister Andrej Plenković presented a €636 million package to mitigate the rise of energy prices. This package of measures applied to households, businesses and farmers. For households, the package referred to subsidies for the cost of gas to households, to tax relief, to social benefits for citizens at risk of energy poverty, and additionally to pensioners with a one-time payment. For businesses, it referred to subsidies for the cost of gas to entrepreneurs. For farmers, it was small-value subsidies for the purchase of artificial fertilizer and a special subsidy program for fisheries and aquaculture. The package would contain the energy price increases to 9.6% for electricity and 20% for gas and it would also address the most vulnerable energy customers, estimated to be over 90,000. This extended the number of eligible people who received vouchers for both electricity and gas bills. **(6)**

On September 8, 2022, the Croatian government announced a Decree containing a multi-part aid package for consumers and the utility company HEP. This package would cost €2.79 billion in total, of which €797 million would be directed towards HEP. The remaining €2 billion was dedicated to helping consumers through the energy crisis and the rising prices associated with it.

On December 22, 2022, Prime Minister Andrej Plenković announced a new package of measures, worth more than €93 million. The one-time financial aid would be targeted to vulnerable citizens in the form of an allowance. 700,000 pensioners – those with a pension of up to €578 – as well as the unemployed, beneficiaries of guaranteed minimum benefits, personal disability benefits, national benefits for the elderly and beneficiaries of financial benefits for unemployed Croatian veterans from the Homeland War. One-time financial assistance was also provided to children’s allowance beneficiaries. **(7)**

Cyprus

On September 17, 2021, the government announced a 10% discount on the electricity bill of all households from November to February. On November 4, 2021, the cabinet approved a reduction of VAT from 19% to 5% on electricity bills for vulnerable groups for six months. The Minister of Finance Constantinos Petrides said that the government would also augment the disbursement of cost-of-living allowances. **(8)**

On July 28, 2022, the government announced that it would absorb 25% of the anticipated rise in autumn energy bills. The finance minister Constantinos Petrides also promised that vulnerable consumers would be completely shielded from upcoming additional costs and that other consumers would get a subsidy, in between 50% and 80% of consumption, designed to encourage users to save on energy use. The new measures would apply to almost 500,000 households and 111,500 businesses.

On November 15, 2022, the government discussed the introduction of windfall taxes for fuel companies and renewables producers through two separate legislative proposals. First, an amendment to the Income Tax Law to introduce a 90% tax on "unexpected earnings" of electricity suppliers from renewables, and of distributors and oil companies for 2022. Second, a permanent fee into bilateral contracts relating to the supply of electricity generated from renewables. The fee would be set at 90% for any amount over and above the maximum market rate per kWh. **(9)**

On December 21, 2022, the Council of Ministers approved an extension for two additional months of the electricity tariffs reduction. The estimated cost was €25 million and covered 449,000 households, 111,500 businesses, and water pumping consumption, and the subsidy would cover residential, commercial, industrial, and water users for bimonthly tariffs for water supply, irrigation, and/or rainwater pumping.

Greece

Plans were announced on September 14, 2021 to offer subsidies on the electricity bills of the majority of Greek households and small businesses until the end of the year and were then expanded in mid-October. The value of the subsidy was initially €9 for the first 300 KWh consumed per month and was later increased to €18 for low voltage consumers and €24 for the beneficiaries of the social household tariff. On January 7, 2022, the subsidy for households was then raised to €42 for the first 300 KWh and €65/MWh for businesses (regardless of size, sector and voltage level). For households included in the Social Housing Tariff (CTO) the subsidy amounted to €180/MWh, i.e. 90% of the increase. The government-controlled Public Power Corporation (PPC) also expanded its existing discount policy to fully cover the price rise for the average household with a consumption of up to 600 kWh per month, according to Reuters. **(10)**

In March 2022, the government's €65/MWh subsidy to the industrial sector fell far from enabling companies to face price spikes in wholesale electricity prices, as observed after the start of the war in Ukraine (€360/MWh on the Greek exchange). Reuters reported that Greece spent some €2.5 billion in power and gas bill subsidies since September 2021 and detailed additional aid of €1.1 billion of upcoming help, which included a fuel rebate for low-income households.

On May 5, 2022, Finance Minister Christos Staikouras announced a new package worth €3.2 billion to relieve pressure on household budgets and businesses from soaring energy prices. Also in May, the Ministry of

Environment and Energy announced that the Greek government would impose a 90% tax on profits made by domestic power companies. The tax would be determined using the months of October 2021 and March 2022. The country's energy regulator (RAE) calculated that these earnings would total more than €900 million. PPC said that it had forgone €336 million in order to assist customers.

On July 5, 2022, Greece announced it would be extending subsidies for households and businesses for the month of July, costing the government more than €700 million. These subsidies awarded €200/MWh to households to cover some 84% of the rising energy bills. Shops would receive €192/MWh and farmers would receive €213/MWh. In addition, industries would receive €148/MWh. With costs of energy prices still rising, Greece announced on August 24 that it was again extended its sweeping energy bill subsidies. On September 21, 2022, Greek Energy Minister Kostas Skrekas said the government would pay out an additional €1.1 billion to households and businesses to shield them from the rising energy prices ahead of winter. On November 3, 2022, the Greek government established a 90% windfall tax rate on energy companies for use in helping citizens pay for rising energy bills. According to the energy minister, the sum would amount to €375 million, collected retroactively from October 2021 to June 2022. **(11)**

Hungary

Prices for households were regulated below cost and on November 11, 2021 the government announced that it would also put a price-ceiling of €1.30 per litre on petrol and diesel. Initially planned to last for three months the cap was extended to last until July. Márton Nagy, Minister for Economic Development, said that the government would raise around €2.06 billion over the next two years from new windfall profits taxes. While covering many sectors of the economy most of the revenues would come from energy sector companies (€760 million), with a large chunk to be collected from Hungarian oil and gas company MOL. **(12)**

On July 13, 2022, the government declared a state of emergency and adopted a 7-point plan on energy security. The government intended to increase domestic gas production to 2.0 billion cubic meters, as well as look for additional sources of gas. Budapest would ban exports of energy resources such as firewood and increase domestic production of lignite. In addition, one lignite-fired power plant in Matra would be reopened and the life of the Paks nuclear power plant near Budapest would be extended. From August 2022, Hungary would scrap caps on gas and electricity prices for high-usage households.

On July 30, 2022, Hungary changed the eligibility for price-capped fuel and increased the windfall profit tax levied on the oil and gas firm MOL. The price-capped fuel, petrol and diesel, was only available to privately owned vehicles, farm vehicles and taxis. The main exclusion was that of company owned cars. For the windfall profit tax on MOL, on August 1st it will be increased from 25% to 40%.

The Commission approved Hungary's amendments to increase the companies' support scheme to a maximum amount of aid at €62,000 per company active in the agriculture sector, €75,000 per company active in fisheries and aquaculture sectors and €500,000 per company active in all other sectors. In addition, Hungary notified of an overall budget increase by approximately €459 million. This would bring the total budget of the energy subsidies scheme to approximately €1.58 billion.

Romania

On September 7, 2021, the Romanian Parliament passed a law to shield vulnerable consumers from the energy price increases from November 1, 2021, with subsidies to be used for home-heating assistance, energy consumption, energy-efficient house equipment and the purchase of products and services improving the energy performance of buildings or connection to the energy network. On October 4, 2021, the Minister of Energy announced compensation for both electricity and gas bills. The measures were expected to last from November 1, 2021 to March 31, 2022 and affected approximately 6 million families or 85% of the Romanian population. In addition to households, compensation was provided to public and private hospitals, schools, nurseries, NGOs and public social service providers.

On October 31, 2021, the Romanian Parliament voted in favour of a bill to implement the above measure and to levy a windfall tax on producers (on revenues exceeding €91/MWh) to finance them. On January 11, 2022, the government announced a new protection scheme for household consumers with a monthly consumption of up to 300 kWh, including a VAT reduction to 5%, as well as compensation for the green certificate and the cogeneration bonus for consumption. The government also applied a support scheme for natural gas. These new measures were introduced at the beginning of April 2022.

On April 11, 2022, the coalition government announced a series of grants and vouchers worth €3.5 billion to help vulnerable Romanians and key industries cope with rising energy prices and supply shocks. The package included aid for small firms' energy bills, grants to attract new investments and support current public works contracts, as well as aid for Romanian farmers and subsidies for fuel prices for transporters. Moreover, some 4.7 million pensioners and other low-income families would receive vouchers for basic food products worth €50 every two months.

On September 9, 2022, the Commission approved the previously announced scheme to support companies of all sizes and sectors. The approved state aid piled up to €4 billion. With respect to limited amounts of aid in the form of direct grants, the aid would not exceed €62,000 and €75,000 per company active in the agriculture, fisheries and aquaculture sectors respectively, and €500,000 per company active in all other sectors. Support under the scheme would be granted no later than December 31, 2022. On December 28, 2022, the government approved an emergency ordinance that introduced a 60% windfall tax on profits exceeding 20% average profits of the previous four years. **(13)**

Slovenia

In January 2022, the government provided a one-off energy subsidy to low-income citizens. Approximately 621,000 people received a one-time energy voucher of €150 and large families received €200. The state would allocate a total of €106 million for this measure and money for the payment would be drawn from the climate fund. From February 1, 2022 until the end of April, households were exempt from paying electricity bills and excise duties on electricity and fuel were lowered. Prime Minister Janša explained that part of the costs for the mentioned measures would be covered from the profits generated from companies which pay an electricity network fee.

In June 2022, Slovenia saw the formation of a new centre-left government lead by Prime Minister Robert Golob, who stated that the energy crisis would be his government's priority. From June 21, the prices of motor fuels at service stations outside the highways were regulated. From July 2022, a more favourable tax treatment for the reimbursement of labour costs was also applied. **(14)**

In September 2022, the government capped the prices of electricity and gas for one year for households and small business customers, and in the case of gas, also for other groups of protected customers (hospitals, medical institutions, homes for the elderly). Until May 2023, a reduced VAT rate of 9.5% was applied to the supply of electricity, natural gas, firewood and district heating. The government also rolled-out aid measures for medium-sized and large enterprises between June 1 and December 31, 2022 by co-financing the costs of electric energy and natural gas above a double increase of their prices.

On December 12, 2022, the government adopted an Act for Governing Aid to Businesses, thus increasing the subsidies aimed at cushioning the increase of prices of electricity, natural gas and technological steam. The Act also introduced job preserving measures and others aimed at ensuring the liquidity of companies. The estimated total aid for all measures amounted to €1.2 billion and the subsidies were intended to last between January 1, 2023 and December 31, 2023. The measures aimed at increasing companies' liquidity instead were expected to last until December 31, 2024. **(15)**

Eliminating Energy Subsidies

Phasing out energy subsidies is a fundamental ingredient of a successful clean energy transition policy, as underscored in the Glasgow Climate Pact. However, the recent global energy crisis also highlighted the political challenges of doing so. In an energy crisis, governments prioritise shielding consumers from damaging price impacts over commitments to phasing out subsidies. This was very visible in 2022 and resulted in a sharp rise in energy subsidies across Europe and other measures to limit the impacts on energy bills. This reduced hardship but diminished the incentive for consumers to save or to switch to alternative –

and cleaner – sources of energy, thereby delaying a lasting resolution of the crisis. It also drained public funds that could have been spent in other areas, including on clean energy transition.

According to the IEA **(16)**, the jump in energy subsidies in 2022 brings some important lessons on the prospects for orderly and people-centred transition.

1. **Fossil fuel prices are not the best way to drive clean energy transition.** Imbalanced or poorly sequenced approaches to transition, in which fuel supply is cut ahead of demand, create clear risks of further price spikes, and there is no guarantee that such episodes are unambiguously good for transition. In practice, concerns about affordability can reduce the attention and money that policymakers devote to clean energy. They can also in some cases (as seen in 2022) prompt higher use of more polluting fuels, i.e. a switch from gas to coal. And the inflationary pressures push up borrowing costs to the detriment of capital-intensive clean energy investments.

2. **High fossil fuel prices hit the poor hardest, but subsidies are rarely well-targeted to protect vulnerable groups and tend to benefit better-off segments of the population.** This was demonstrated again in 2022, as the political priority to respond quickly often overrode the more painstaking task of directing support where it was needed most. Effective targeting requires prior investment in better data collection and in setting up effective cash transfer mechanisms.

3. **Better to spend on structural changes than on emergency relief.** Resources are best deployed in promoting changes that provide lasting protection against volatile fuel prices. This means anchoring market-based prices in a broader suite of policies and measures that enable cleaner choices by households and industries. This should make high-efficiency and low-emissions equipment and services readily available, and help poorer consumers to manage the upfront costs of these investments.

High energy prices hit the poor hardest but subsidies are rarely well-targeted, and as a result tend to benefit the better-off, notes the IEA. Effective targeting to protect vulnerable groups requires investments in better data collection and in setting up effective cash transfer mechanisms. But well-designed policies should avoid fuel supply getting too far out of step with demand in the first place. Resources are best deployed to provide lasting protection against volatile fuel prices. This means anchoring market-based prices in a broader suite of policies and measures that enable households and industries to make cleaner energy choices. High-efficiency and low-emissions equipment and services need to be readily available, and poorer consumers need support to manage their upfront costs. It is far better for governments to spend time and money on structural changes that bring down energy demand, rather than on emergency relief when fuel prices go up.

The IEA has long advocated removing or at least reducing energy subsidies because they distort markets, send the wrong price signals to users, widen fiscal deficits in developing economies, and discourage the adoption of cleaner renewable energy sources. Their expansion is particularly worrying at a time when we should be redoubling efforts to cut wasteful consumption and accelerate clean energy transition. Reforming prices is a political challenge, but it is also economically and environmentally vital. **(17)**

Energy subsidies may also accelerate inflation. While some suggest that a well-designed price cap can help curtail inflation domestically because indices measure the price for consumers rather than the total price including subsidies, subsidies could actually contribute to higher global inflation. Indiscriminate subsidies can encourage demand by making consumption cheaper; since there is a limited supply of fossil fuels, any increasing demand risks driving global prices higher.

Inflation is already a huge problem. The response of central banks around the world has been to put the brakes on the economy by increasing interest rates, threatening recession and making life harder for many. This is especially the case for lower-income countries: with debt denominated in US dollars, the rising exchange rate means it is more expensive to service their debt in their national currencies. At the same time, Europe's willingness to pay for scarce energy resources is driving up costs around the world, pricing out many poorer, energy-importing countries.

Discussion

The European Commission has asked EU member states to start phasing out the huge energy support measures, in an attempt to restore budget rules three years after the coronavirus pandemic erupted. The surge in energy prices in 2021 and 2022 due to the energy crisis, additionally fueled by Russia's attack on Ukraine, forced the countries of the European Union to implement fiscal policy measures with sizable costs, while helped households and firms to cope with the high costs of electricity and natural gas.

According to the European Commission, more than 70% of the amount dedicated to energy support in 2022 corresponded to measures that were not sufficiently targeting the most vulnerable households and firms. Furthermore, two thirds have distorted the price signal and may have reduced incentives to contain energy consumption and aim for increased energy efficiency.

The attempt to eradicate energy subsidies is a difficult issue and the European countries, including SE Europe, should be careful in the termination of support measures and phase out the least targeted ones first. The Commission reiterated its long standing position that the best cure for the energy crisis is to reduce dependence on imported fossil fuels, invest in energy efficiency, diversify energy supply and accelerate the development of renewables.

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