

The fiscal side of Europe's energy crisis: facts, problems and prospects

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It is often said that nothing is so permanent as a temporary government programme. And when it comes to the fiscal side of Europe's energy crisis, this certainly seems to be the case.

As energy prices began to increase across Europe in Summer 2021, governments started to adopt fiscal measures aimed at subsidizing the energy bills of both families and businesses. These measures were initially intended to be temporary, if not even one-offs.

However, as prices kept creeping up after the Russian invasion of Ukraine, fiscal measures multiplied and inexorably ballooned in size.

Facts

As shown in our Bruegel dataset on National fiscal policy responses to the energy crisis, between September 2021 and January 2023 EU governments allocated and earmarked €657 billion to shield households and firms.

It is important to stress that these figures represent budget allocations and earmarking - i.e., they might not have been entirely used up yet.

In absolute terms, three countries alone constitute 70 percent of the overall allocation by EU countries: Germany (€264 billion), Italy (€92.7 billion), and France (€92.1 billion). In relative terms, allocations range between 9% of GDP in Slovakia to less than 1% in Finland.

From an economic policy point of view, one of the most important questions concerning these interventions is whether they have been targeted at certain categories or not.

We investigated the funding allocated and earmarked for households specifically and found that EU governments have largely favoured un-targeted price-distorting measures compared to targeted income-supporting measures.

To date, targeted policies have represented only 25% of the total funding disbursed. This most likely reflects the urgency of action during the peak of the energy crisis, as these measures are relatively easy to roll-out and their effects are immediately felt by consumers.

Problems

Yet, interventions of this kind are problematic for several reasons.

First, they might reduce the incentive to save energy, propping-up consumer demand and consequently worsening the energy demand-supply imbalance lying at the core of the crisis.

Second, price distortions to block the passthrough of high fossil fuel prices might have been a social and political necessity at the height of the energy crisis, but contrast with commitments to the energy transition as they are fossil fuel subsidies.

Third, such measures are expensive to sustain over time.

Fourth, they are not necessarily equitable. Some price-suppressing measures can even be regressive in some European countries.

Fifth, untargeted price distorting measures might lower peak inflation in the short term but set the conditions for an extended period of elevated inflation in the longer run. As stressed by ECB President Lagarde, delaying their dismissal might compromise the ECB's ability to achieve its medium-term objectives, resulting in monetary tightening for longer than what is otherwise desirable.

Sixth, they are politically difficult to discontinue. In fact, governments may face strong political backlash from citizens when measures are removed.

Seventh, they have global distributional implications, preventing demand adjustments in countries on the top of the global income distribution indeed prolongs high prices on global energy markets harming energy-importing, lower-income economies.

Prospects

Moving forward, European governments have been advised to abandon un-targeted price-distorting measures.

For instance, the ECB has consistently recommended to prioritize measures that meet a "triple-T" criterion: temporary, tailored and targeted.

However, we need to move beyond emergency fiscal responses and focus on structural changes to allow the EU to decisively accelerate its decoupling from fossil fuels. Doing so would provide a better and longer insurance against fuel price volatility.

Phasing-out the dependence on fossil fuels to prioritize access to affordable, clean energy sources would also restore and maximise the competitiveness of the EU's industry hard-hit by high energy prices and losing out to global competition as a result.

Thus, we think it will be important to further develop the ECB "triple-T" criterion into a "Green triple-T", for policies to be transition-proof, tailored and targeted.

According to the “Green triple-T” criterion, policies should be transition-proof: this means that they should lower the economic cost and administrative burden of switching to renewables and of improving energy efficiency.

They should be tailored to incentivize price-induced demand response to reduce energy consumption when needed.

However, governments should be wary of increasing inflationary pressures and eroding the real income of households. This is why they should be targeted to support the most vulnerable households adapt their energy consumption and adopt green-proof solutions.

As the peak of the energy crisis increasingly seems to be behind us, governments now have a window of opportunity to re-direct support in a more efficient and equitable manner and expedite their commitments to the energy transition. That is, developing and implementing a “Green triple-T” framework might offer governments an opportunity to exit the energy crisis by making Europe greener and fairer.