

## MFT Policy Brief 2 (EN)

# “Enabling conditions” for a green transition and how the EU is performing

### Abstract

Apart from specific climate policies like the European Emission Trading System or the ban of cars with combustion engines, certain accompanying policies are necessary for a successful green transition towards a sustainable Europe with zero emissions. Such accompanying policies are often referred to as “enabling conditions” for the success of more specific climate policies. In its monitoring report for the 8th Environment Action Programme (EAP)<sup>1</sup> from November 2023, the European Environment Agency (EEA) looks at five indicators corresponding to such “enabling conditions”. Those indicators measure the **share of environmental taxes** in total tax revenues, the amount of **fossil fuel subsidies** and **environmental protection expenditure**, the share of **bonds supporting sustainable investments** on the bond market, and the progress in **ecological innovations**. In this MFT Policy Brief, we will give you an overview about the EEA’s judgement and forecast with regard to how the EU performs in terms of „enabling conditions“.

### What is the EEA and what are “enabling conditions”?

The European Environment Agency (EEA) is an agency of the European Union that provides independent information on the state of Europe’s environment. The EEA works closely together with a variety of European organisations to collect and validate data and to analyse it (EEA Website 2024). Thereby, it supports the EU’s environment and climate policies.

In its monitoring report on the progress towards the EU’s environmental policy objectives, the EEA dedicates one chapter to so-called “enabling conditions”. This term describes a series of rather general policies, which we look at in the following. However, the successful implementation of these policies is an essential prerequisite for achieving more specific environmental policy goals like Green

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<sup>1</sup> The EAP strengthens the EU’s long-term vision for 2050 of living well within the planetary boundaries, by setting priority goals for 2030 and the conditions to achieve them (European Commission 2022).

House Gas emission reductions (EEA 2023a: 75). The EEA developed a monitoring framework to capture the progress related to these “enabling conditions”. This monitoring framework includes five indicators that we want to explain to you in the next sections to ultimately answer the question if the EU is on a good way to create the conditions necessary in order for the green transition to be successful.

## Environmental Taxes

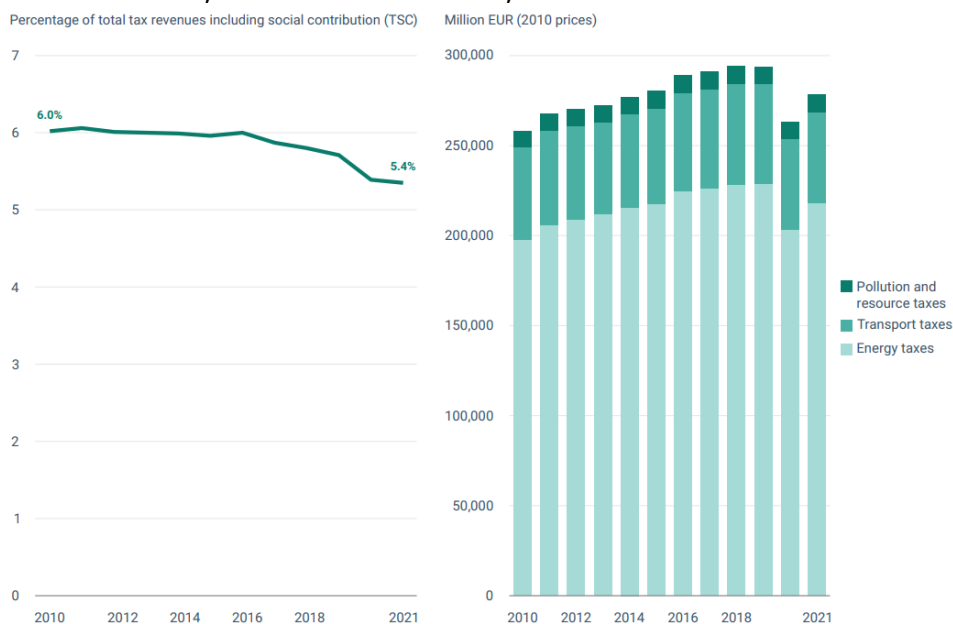
One way to make our society more sustainable is to make sure that consumers in the EU buy more and more environmentally friendly products. One enabling condition for that is making harmful products more expensive by adding a tax. Environmental taxes, our first enabling condition, are therefore additional taxes on products that have a negative impact on the environment. They provide price signals and incentives to producers and consumers on all markets to decrease their emissions and to use natural resources more carefully. Regarding the *environmental tax indicator*, the EEA (2023a) concludes that it is likely but uncertain that the share of environmental taxes in total tax revenue will increase. Furthermore, the EEA reports that from 2010-2021, this share decreased from 6% to 5.4% (see Figure 1). This can be linked to the social and economic challenges that governments face by maintaining or increasing environmental taxes. Increasing environmental taxes can drive up the cost of food and energy which, in the short run, can lead to lower consumption, more inequality and ultimately less economic stability.

For the EEA, it seems likely that the share of environmental taxes will increase by 2030 because of the increased ambition and the augmented scope in the EU's Emission Trading System (ETS). Through the ETS, the EU's collective emissions are subject to an environmental tax. In fact, they account for 78% of the energy tax revenue<sup>2</sup>. It is expected that the revenue from the EU-ETS will increase because more and more sectors will be covered. In the long-run, this increase will reach its peak and decline afterwards due to more ambitious Greenhouse Gas (GHG) reduction targets. Nevertheless, this forecast is uncertain as a rise in the revenues from the ETS may be balanced out by a decrease in revenues from the current energy taxation schemes - due to increasingly ambitious GHG emission reduction targets. This might sound like a contradiction at first, but it makes sense if you consider that with lower general GHG emissions there will be fewer emissions to be taxed. So even if tax rates go up (indirectly through the ETS), the revenue might decline as emissions are cut further and further. However, this can be interpreted as positive due to the reduction of GHG emissions in the long-run .

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<sup>2</sup> Subsuming the ETS under the category of environmental taxes is somewhat strange. From an economic perspective an emission trading system works very differently than an environmental tax. If you want to learn more about the ETS, read our MFT Policy Brief X.

Figure 1. Environmental tax revenues: share in total revenue from taxes and social contributions, and absolute value, EU



Source: EEA (2023a) with Data from Eurostat.

## Fossil Fuel Subsidies

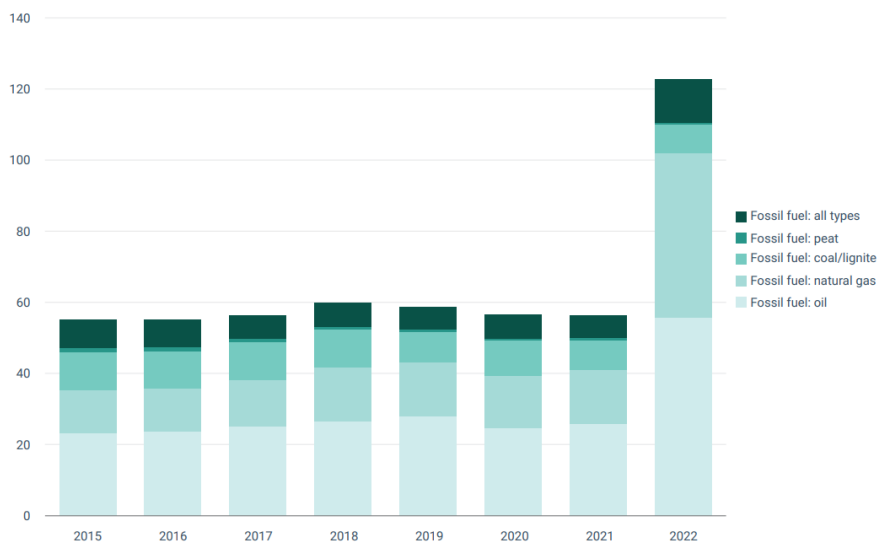
Even though the EU strives for climate neutrality, Brussels and the member states are still subsidising the consumption of fossil fuels - the biggest driver of the climate crisis. Fossil fuel subsidies remained stable throughout 2015-2021, with almost half supporting oil and more than a quarter supporting natural gas. The increase of more than 60 billion Euros (see Figure 2) in 2022 can be attributed to the response to high energy prices due to the war in Ukraine. The EEA (2023a) concludes that it is **unlikely but uncertain if there will be much progress in phasing out fossil fuel subsidies by 2030**. The report states that neither the EU, nor most EU member states have plans to phase out the subsidies that were in place before the start of the Russian invasion of Ukraine (EEA 2023a, Antimiani et al. 2023). However, it is essential to mention that, according to the EEA, the increase in 2022 is considered temporary because almost half of the total fossil fuel subsidies in 2022 have a planned end date before 2025. In spite of this explanation, the factual doubling of EU fossil fuel subsidies since 2022 instead of a phasing out speaks for itself. This means that currently, over 120 Billion Euros of EU funds are directly turned into profit for the industry most heavily aggravating the climate crisis<sup>3</sup>. It might be worth mentioning that main suppliers in this industry like Exxon Mobile have known about the devastating effects of the climate crisis since the 1970s and purposefully spread disinformation<sup>4</sup>.

<sup>3</sup> See e.g. Our World In Data: <https://ourworldindata.org/ghg-emissions-by-sector>

<sup>4</sup> Supran, G., & Oreskes, N. (2017). Assessing ExxonMobil's climate change communications (1977–2014). *Environmental Research Letters*, 12(8), 084019. <https://doi.org/10.1088/1748->

Figure 2. Fossil fuel subsidies, EU

Billion EUR (2022 prices)



Source: EEA (2023a) with data from the European Commission

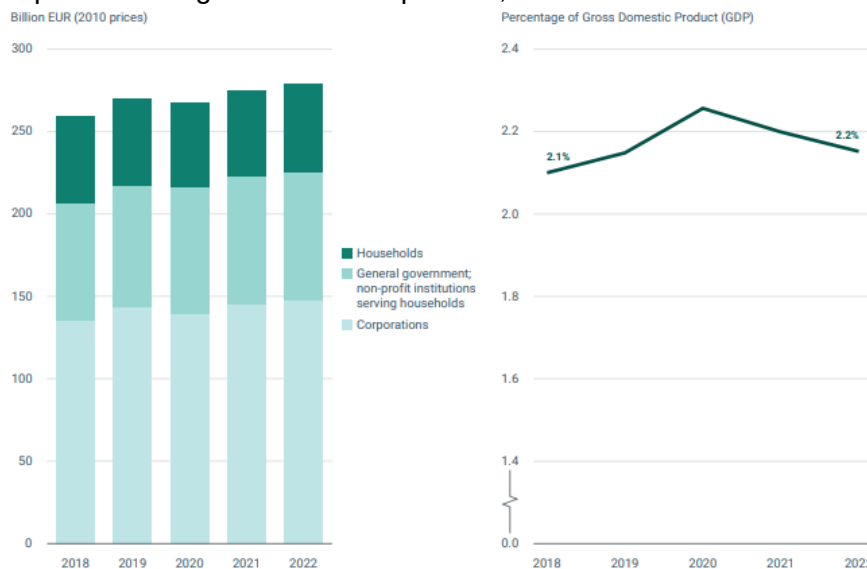
## Environmental Protection Expenditure

The EEA (2023a) rates it as very likely that more financial means will be spent on projects that actively preserve and protect the environment - so-called *environmental protection expenditure (EPE)*. This indicator captures the **expenditure of private businesses as well as governments related to reducing air, water, soil and noise pollution, protecting biodiversity, managing wastewater and waste in general, and environmental research and development. An increase in this indicator would mean that pollution and GHG emissions are reduced and that for example new technologies are supported to decrease pollution in the long run.** Between 2018 and 2022, the EPE share in GDP remained stable at around 2% (EEA 2023a). Empirical analysis shows that the amount of expenditures is insufficient for EU economies to reach their environmental protection goals (Caglar & Yavuz 2023). Most are spent on waste management, wastewater treatment and operating expenditures. Only around 20% was spent on investments in environmental research and development in 2022. An overall increase in the share of environmental protection expenditure in GDP in 2020 can be explained by the decline in GDP due to the COVID-19 pandemic (EEA 2023a).

To be able to foster the green transition effectively, EU countries should allocate a larger budget for environmental protection (Caglar & Yavuz 2023). It is estimated that approximately 77 billion euros per year for environmental protection and 53 billion euros per year for resource management and the circular economy transition are needed. However, the EEA concludes that it is very likely that environmental protection expenditure will increase in the following years. Due to

an increase in the EU budget, the spending program “NextGenerationEU”<sup>5</sup>, and sustainable finance actions<sup>6</sup>, additional financial resources have been made available. On the other hand, it is too early to know if the additional resources can trigger the necessary private capital flows to fill any additional investment needs that might occur by 2030 (EEA 2023a).

Figure 3. Environmental protection expenditure and share of environmental protection expenditure in gross domestic product, EU



Source: EEA (2023a) with data from Eurostat

## Green Bonds

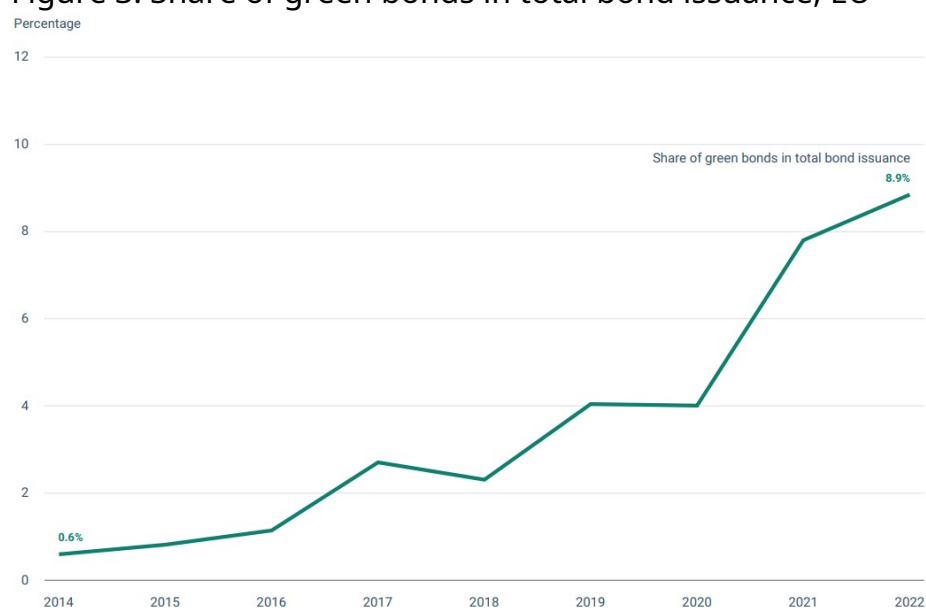
Green Bonds are bonds that are **used to finance or re-finance investments, projects, expenditures or assets, that help to address climate change** and environmental problems (Spinaci 2022). They are issued by either public or private entities and are **bought by investors**. In the case of the *green bonds indicator*, the EEA (2023a) report states that it is likely but uncertain that the share of green bonds will increase. Between 2014 and 2022, the share of green bonds in total bonds issued increased (see Figure 3). However, this has to be seen with caution because it is unknown how much greenwashing<sup>7</sup> is done in those bonds. The EEA explained that all entities that issued green bonds increased their amount during

<sup>5</sup> “NextGenerationEU” is an investment and recovery plan by the EU to face the economic impacts of the COVID-19 pandemic and to make Europe healthier, greener and more digital (EU 2024).

<sup>6</sup> „Sustainable finance refers to the process of taking environmental, social and governance (ESG) considerations into account when making investment decisions in the financial sector, leading to more long-term investments in sustainable economic activities and projects“ (Definiton from the European Commission 2024) (A more detailed definition can be found on the respective webiste (see references)).

those years. This reflects the increased demand from investors to finance green projects and activities and the growing interest of the financial sector in offering financial instruments that support those activities. The report concludes that it is likely but uncertain that the share of green bonds will increase in the coming years. The demand will remain high, driven by the European Green Deal's ambitious environmental and climate objectives. The European Commission intends to issue more green bonds itself to fund the NextGenerationEU recovery plan (EEA 2023b). The so-called framework conditions for sustainable finance have been changed in the EU to boost sustainable investments and, thereby, the issuance of green bonds (EEA 2023a).

Figure 3. Share of green bonds in total bond issuance, EU



Source: EEA (2023a) with Data from EIKON/ESMA/EEA.

## Eco-innovation index

Lastly, the EEA (2023a) evaluates that it is very likely that the *eco-innovation index* will improve. Eco-innovation is defined as **any innovation that reduces environmental impacts, increases resilience to environmental pressures, or uses natural resources more efficiently**. The eco-innovation index shows an increase from 2013-2022, mainly driven by improvements in various aspects of resource efficiency. The EEA concludes that it is very likely that there will be further increases in the index in the coming years. This can be explained by the continuous increase over the past years and the high ambition of environmental

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<sup>7</sup> Greenwashing is a term that describes the practice of advertising financial products or services as „sustainable“, even though they do not actually achieve the criteria for that classification (BaFin 2024).

and climate objectives of the European Green Deal and its resulting initiatives, which will most likely drive the increasing progress in eco-innovation.

## Conclusion

It can be seen that the EU is on a path to increase its ambitions to reach the environmental targets. With regard to pricing instruments like environmental taxes or the EU Emission Trading System, according indicators are expected to further improve as a consequence of stricter policies. Ecological innovation and a transition of financial instruments towards a higher consideration of sustainability implications are also projected to gain speed. However, in order to achieve the 2030 and, more importantly, the 2050 goals, further improvements with regard to “enabling conditions” are critical.

Especially in the case of fossil fuel subsidies and environmental protection expenditure, the EU lags behind and, therefore, sabotages its own climate goals. In following MFT Policy Briefs, we will shed more light on specific proposals to reduce fossil fuel subsidies and further enlarge on the question of how much public investment would be necessary to foster a rapid and socially just green transition and how such investment could be harnessed.

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