

25 March 2024

## Opinion of the Climate Policy Observatory on Luxembourg's fossil fuel subsidies

In response to the energy crisis, the Luxembourg government has introduced an energy allowance for low-income households<sup>1</sup> and has decided to subsidise<sup>2</sup> electricity and fossil fuels to help consumers more generally. From a social perspective, the Climate Policy Observatory (OPC – Observatoire de la Politique Climatique) recognises the importance of financial support for vulnerable consumers but notes that subsidising fossil fuels exacerbates climate change. Fossil fuel subsidies keep prices artificially low and prevent the desirable effect of higher prices reducing demand for fossil fuels. Such subsidies may thus delay the energy transition, and may even lead to long-term carbon lock-ins.

The European Scientific Advisory Board on Climate Change (ESABCC) addressed the issue of fossil fuel subsidies in a letter<sup>3</sup> to the energy and climate ministers of the 27 EU Member States, laying out a series of recommendations on how to align policy responses to rising energy prices with the long-term goal of climate neutrality. In a recent report on progress, policy gaps and opportunities towards EU climate neutrality<sup>4</sup> the ESABCC makes two similar recommendations:

- "Member States should clearly specify in their updated NECPs how and by when they will phase out fossil fuel subsidies, including a clear trajectory towards a full phase-out by a specific year in the immediate future. [...] Support measures for vulnerable households that constitute a fossil fuel subsidy should be altered to well-targeted interventions that do not undermine the incentive for energy savings or the shift towards renewable energies." (p. 242)
- "A rapid phase-out of fossil fuel subsidies would increase Member States' revenues or reduce their expenditures, which could then be reoriented to finance climate investments." (p. 243)

In addition, international commitments such as COP26 Glasgow Climate Pact<sup>5</sup>, COP28 UEA consensus<sup>6</sup>, the European Green Deal<sup>7</sup> as well as the EU's Eighth Environment Action Programme<sup>8</sup> call

<sup>1</sup> <https://guichet.public.lu/en/actualites/2022/mars/22-prime-energie.html>

<sup>2</sup> [https://gouvernement.lu/en/actualites/toutes\\_actualites/communiqués/2023/01-janvier/o4-turmes-cdp.html](https://gouvernement.lu/en/actualites/toutes_actualites/communiqués/2023/01-janvier/o4-turmes-cdp.html) and [https://gouvernement.lu/fr/actualites/toutes\\_actualites/communiqués/2023/03-mars/07-tripartite-signature-accord.html](https://gouvernement.lu/fr/actualites/toutes_actualites/communiqués/2023/03-mars/07-tripartite-signature-accord.html)

<sup>3</sup> [www.eea.europa.eu/about-us/climate-advisory-board/recommendations-to-eu-and-member/view](http://www.eea.europa.eu/about-us/climate-advisory-board/recommendations-to-eu-and-member/view)

<sup>4</sup> <https://climate-advisory-board.europa.eu/reports-and-publications/towards-eu-climate-neutrality-progress-policy-gaps-and-opportunities>

<sup>5</sup> Decision 1/CP.26 in FCCC/CP/2021/12/Add.1 <https://unfccc.int/documents/460954>

<sup>6</sup> Outcomes of the Dubai Climate Change Conference - Advance Unedited Versions (AUVs) and list of submissions from the sessions in Dubai <https://unfccc.int/cop28/outcomes>

<sup>7</sup> EC, 2019, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions 'The European Green Deal', COM (2019) 640 final of 11 December 2019. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2019:640:FIN>

<sup>8</sup> EC, 2022, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the monitoring framework for the 8th Environment Action Programme: measuring progress towards the attainment of the programme's 2030 and 2050 priority objectives, COM (2022) 357 final of 26 July 2022. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2022:357:FIN>

for an immediate phase out of subsidies for fossil fuels. The International Monetary Fund<sup>9</sup> estimates that removing explicit and implicit fossil-fuel subsidies across all countries would “prevent 1.6 million premature deaths annually, raise government revenues by \$4.4 trillion, put emissions on track towards reaching global warming targets, and would also redistribute income, as fuel subsidies benefit rich households more than poor ones.”

In alignment with the ESABCC, and these international agreements, the OPC wishes to put forward three alternative approaches to address the social and economic impacts of rising energy prices, while at the same time protecting the Luxembourg economy from the risk of runaway inflation due to rapidly rising energy costs and wage indexation.

### 1. Provide direct income support for vulnerable consumers

The OPC would like to highlight the ESABCC recommendation on providing direct income support to vulnerable consumers instead of competition-distorting price interventions, such as energy subsidies. The ESABCC states that:

*“Targeted support can mitigate the worst social and economic impacts of the crisis while prices remain high. Member States should target support measures at vulnerable consumers, including low-income households and economic sectors struggling with high energy costs. Direct income support is preferred over price-distorting interventions, as it maintains the price signal for energy savings and investments in renewables. Targeted price reductions such as social tariffs or block tariffs could be considered as a second-best solution, as they distort the marginal price signal to only a limited degree. The Advisory Board recommends that the EU and its Member States refrain from non-targeted, distortive price interventions, such as general tax reductions and energy subsidies, as such measures are costly, ineffective, as they undermine the incentive to reduce demand and could potentially trigger a subsidy-driven price spiral, and could lead to hard-to reverse fossil fuel lock-ins with adverse implications for the climate.”*

Source: [www.eea.europa.eu/about-us/climate-advisory-board/recommendations-to-eu-and-member/view](https://www.eea.europa.eu/about-us/climate-advisory-board/recommendations-to-eu-and-member/view) (p. 6)

### 2. Adjustment of the National Consumer Price Index (IPCN) basket

The OPC understands that one of the reasons for the current subsidy scheme is a political compromise to prevent wage increases triggered by the National Consumer Price Index (IPCN – Indice des Prix à la Consommation Nationale) basket linking consumer prices to wages. Considering the high likelihood that the energy crisis will extend over several years or become a recurrent event triggered by different circumstances due to the increasing instability of global energy markets and geopolitics, it is expected that energy prices will remain high or increase even further in the coming years. These long-term perspectives suggest that direct fossil fuel subsidies are not only harmful in terms of climate change but also unsustainable given the increasing number of competing pressures on public funds.

Whilst the OPC is aware that adjustments to the IPCN basket are politically sensitive and technically complex, the exclusion of fossil fuels from the IPCN basket would make the IPCN sustainable and prevent further increases in energy prices from directly triggering wage increases. Similar measures are also being considered by other EU countries.

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<sup>9</sup> <https://www.imf.org/en/Blogs/Articles/2023/08/24/fossil-fuel-subsidies-surged-to-record-7-trillion>

### 3. Investment in indirect measures to reduce the need for fossil fuels that are targeted at more vulnerable consumers

The OPC's first annual report<sup>10</sup> highlights a series of recommendations that could be considered to reduce the need for fossil fuels instead of subsidising fossil fuel purchases. The OPC believes that in the event of a sudden rise in the cost of living, it would be more effective to provide direct transitional income support to vulnerable consumers than to subsidise fossil fuels. The recommendations that are most relevant in this context include improving public transport, promoting shared electric car schemes, subsidies for (district) heat pumps and connection to district heating networks, as well as collectively organised retrofitting schemes for improving the energy performance of houses. Such measures would considerably reduce the dependence of Luxembourg citizens on fossil fuels in the medium and long-term.

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<sup>10</sup> [https://environnement.public.lu/content/dam/environnement/documents/klima\\_an\\_energie/observatoire-politique-climatique/opc-ra-propositions-ok.pdf](https://environnement.public.lu/content/dam/environnement/documents/klima_an_energie/observatoire-politique-climatique/opc-ra-propositions-ok.pdf)