Stopping Russian fuel imports will help the green transition

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Summary: We argue that the EU's energy policy response to Russia's invasion of Ukraine needs to meet three objectives: enforce sanctions on Russia, maintain the green transition, and avoid adverse distributional impacts on the most vulnerable. With energy prices already at high levels since last fall, achieving these objectives requires restraint from blanket policy measures and only targeted financial support.

The Russian invasion of Ukraine marks the end of the greater, seven-decade long European project of building peace and security through trade integration and political collaboration. Trade and political sanctions are the EU's primary, non-military responses to attacks on peace. Between the sanctions' severing of ties with the Russian economy and the war's destruction of Ukraine's economy, enormous resource flows are effectively being blocked or at risk of being blocked from European and global markets. The EU is particularly dependent on Russian energy exports and its energy infrastructure makes switching suppliers difficult. Yet, this large market share also gives EU's sanctions their bite. The policy responses need to consider not only the immediate geopolitical threats but also the future ones—including climate change and the energy transitions the EU has already committed to.

High fossil fuel prices go higher

Russia supplies up to 100% of some European countries' natural gas imports and, according to the International Energy Agency, it is the world's largest exporter of oil, with 60% of that supply going to OECD Europe. Ukraine is also number one in Europe when it comes to proven recoverable reserves of uranium ore, third in shale gas and eighth in coal reserves. The war might therefore not only impede current but also future supply of fossil resources to the EU.

Western leaders do not want to risk a military escalation of this conflict, leaving trade sanctions, especially on gas and oil, as their primary tool to push back against Russian aggression. Consumers are already starting to notice significant price increases in oil and gas. As these sanctions are likely to stay in place for some while to come, we should not expect fossil prices to decrease in the near future.

Impact on green transition

Although there are short-term costs of higher fossil fuel prices, there are some important gains over the medium term. High fossil fuel prices not only strengthen the sanctions but also could help the transition to cleaner energy. This will lead to future energy independence from countries such as Russia, which are exploiting this energy dependency for geopolitical purposes. But in the near term, the potential supply chain disruptions from Ukraine, coupled

with the fossil sanctions on Russia, are going to lead to a significant shortfall in both oil and gas imports.

An outright ban or severe curtailment of Russian gas and oil imports will push up the costs of living for European citizens, which will hurt the poorest the most. Adverse effects on the economy would be unavoidable and likely substantial but expected to be manageable. For example, a recent study calculates that for Germany, the EU country that is most highly dependent on Russian gas, a ban on gas would lead to a drop in GDP of 0.5 to 3%, a bit less than the decline during the pandemic. Although Russian imports of coal and oil can be replaced by imports from elsewhere, this is not so easy for Russian gas, at least in the short run. While some additional gas imports are expected to be possible, potentials for a short-run reduction of consumption are limited. Relying more on electricity generation from coal and nuclear, increasing gas storage and reducing gas demand for heating, for example, can contribute to reducing the shortfall in gas imports. In the longer run renewable energies such as solar and wind power can take over from Russian gas.

This suggests that the EU should intensify climate policies by getting rid of fossil fuels more quickly and replacing it by renewable energies, also investing in storage, (international) connector networks, energy sobriety and energy efficiency. To encourage this, the EU has to implement necessary policies now. It has to start coordinating member states' responses more efficiently and commit to higher gas prices. A delayed response would make the EU open to blackmail in the next winter. A ban of Russian gas now could underscore the EU's commitment and send a very strong signal to European households and firms to adjust before the autumn and winter. An increased use of coal could be compensated through a tightened EU ETS cap.

Stopping misguided policies

Despite this, many European countries are thinking about implementing policies that reduce fossil fuel prices in the short term, regardless of the consequences for the transition to clean energy and the reduction in fossil fuel dependency. For example, France has frozen the consumer gas price, and set a maximum annual increase of 4% for the consumer electricity price. Furthermore, the French Prime minister has announced a rebate of 15c per liter of fuel, on all fuels, from April the 1st to the end of July. Belgium, Netherlands and Spain want to cut the value added tax temporarily, as well as taxes on fuel and gas. Sweden just lowered fuel taxes. Germany is considering subsidizing petrol and diesel prices for at least the next few months, while German politicians are so far unwilling to cut off gas imports from Russia as part of the sanctions. Germany announced the suspension of the Nord Stream 2 pipeline, but it is possible that, once the conflict passes, this pipeline will be developed fully. The UK and USA decided to completely stop oil imports from Russia, but these countries are not really dependent on Russian energy.

Wanting to lower gas prices by cutting taxes on fossil fuel or through a temporary VAT cut as in the Netherlands and Spain is an understandable reaction, but a bad idea for four reasons. *First*, they are an unnecessarily expensive way to help the poor as they provide relief to higher incomes as well. Reducing the burden to the poor cost-efficiently would also leave more financial scope for the multitude of investments that are needed for a faster decarbonization. Rather than wasting money on the rich, poorer households could receive targeted income transfers without reducing incentives to save carbon-intensive energy. Germany, for example, plans a lump-sum payment to poor households. If commuters who cannot switch to other modes are particularly affected, they could be specifically compensated: for example, Austria

plans to redistribute revenue from carbon taxes by regionally differentiated transfers. *Second*, misguided policies such as lowering gas prices frustrate rather than accelerate the green transition. *Third*, such policies inadvertently put upward pressure on gas prices and thus offer an additional windfall bonus for Putin, further increasing his war chest. *Finally*, lower taxes will hamper innovation towards clean energy. It is an undesired irony of Putin's war on Ukraine that it managed to raise fossil fuel prices to levels that are quite close to what economic models have determined to be the socially optimal price of fossils for transitioning to cleaner energy. Smart policy makes use of such unintended gifts.

Reacting to higher gas prices by subsidizing fossil fuel use or delaying carbon pricing is highly likely to be counterproductive. Although it helps the poor at first blush, it also delays necessary climate action and therefore will require more costly climate policies with even higher carbon prices in the longer run. That will hurt the poor even more. The EU's REPowerEU initiative in response to Russia's attack correctly recognizes all aspects and proposes concrete measures for a short-run diversion to other suppliers and long-run reduction in fossil fuel use.

Oil and gas companies will predictably lobby politicians to increase exploration and production, to increase subsidies and reduce taxes. This has the potential to perpetuate our fossil fuel dependency for years to come, rather than decreasing it. Giving in to such lobbying will prove troublesome for our climate action ambitions.

There also needs to be a domestic policy implemented on fossil fuels to control the spur to increased domestic production that will come from substitution arising from reduced imports. Certainly removing any remaining exploration, production and consumption subsidies that support domestic expansion and use of fossil fuels is important. In this regard, the EU might also consider adjusting or tightening its ETS cap and rules to keep overall greenhouse emissions under control, even if coal use might rise temporarily in the coming months.

The conflict in Ukraine is likely to last some time, and whatever the outcome, the sanctions on Russia are there to stay. Reducing the reliance on imported fossil fuels is the only sensible goal, and it furthermore helps drive the energy transition. Moving away from geographically concentrated fossil fuels towards worldwide spread renewable sources like wind and solar would eliminate our dependence on specific countries and reduce the geopolitical risks associated with it. We should not rely on Russian fossils any longer. Focusing energy independence on renewables also helps to push the energy transition, killing two birds with one stone.

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