

# Escaping the Permanent Suez: Obstacles to European green investment

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*This memo is based on joint work with Ben Judah and Shahin Vallée at Atlantic Council*

The transition to the oil age was brutal for Europe. Simply put, unlike Russia, the Gulf monarchies, and the United States, the soil and seas of the European states do not have enough to power themselves—this fact has left it at a historic disadvantage.

As coal's winners declined, oil's winners rose: chiefly the United States, Russia and the Gulf monarchies. And Europe has been caught—in various relationships of dependency and vulnerability—between these three energy powers ever since. Even to this day, this fundamental underlying condition hasn't changed. Russia's assault on Ukraine, triggering its energy war and the massive inflationary shock that has rolled over its consumers, has driven European treasuries deeper into debt. In 2022, just like in 1973 when it was hit with the Arab oil embargo, Western Europe found its fundamental vulnerability exploited over a war on its periphery. Though wrong in his ethics and execution, history has proved that British Prime Minister Anthony Eden was right to perceive the Suez Crisis and the passing of European hegemony in the Middle East as a critical turning point: its prosperity ever since has been punctuated by the kinds of authoritarian blackmail he feared.<sup>1</sup> This is what we identify as the *Permanent Suez*.

Europe's geopolitical viability in this transition will depend on it overcoming a series of internal blockages that hamper its ability to act to resolve a number of challenging trade-offs. Domestic, foreign, and energy policies cannot be disentangled in the geopolitics of the transition to net zero. The European Union's political system will have to overcome five fundamental internal challenges related to energy, fiscal, and foreign policy in order to navigate effectively.

The first is the *fiscal problem*, which is that the bloc's fiscal rules and its ineptly small EU budget limit the necessary financing for such an endeavor. The second is the *hostage problem*, which is that national politics have been held hostage by domestic anti-transition forces and interests. The third is the *collective action problem*, with national veto players at the European level able to hold back collective EU policy. The fourth is the *just transition problem*, exemplified by the gilets jaunes, the French mass protest movement that showed the risk of a lack of popular legitimacy for an anti-redistributive transition when emissions are known to be caused mostly by the richest countries and social groups. The fifth is the *industrial problem*, which is that Europe's industrial base is eroded and industrial dirigisme is hard, prone to white elephants and getting harder as climate change and geopolitical competition disrupt supply chains. Addressing these fundamental questions and these difficult trade-offs is essential for Europe to take the necessary leap out from its permanent Suez crisis—or see it worsen.

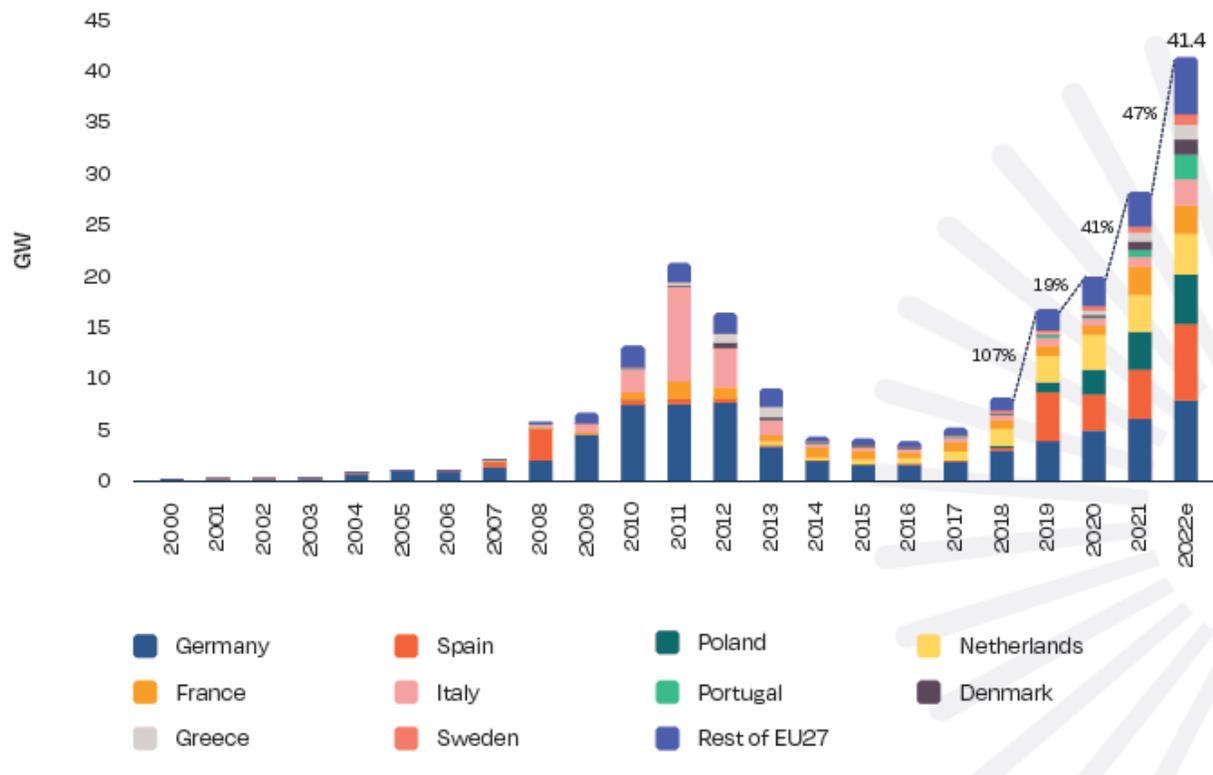
## 1. THE FISCAL PROBLEM

### *Europe's Fiscal Straitjacket Harms Decarbonization*

To understand why the choice of macroeconomic policy determines countries' ability to go green, look at what happened to green investments during the Eurozone's ruinous 2010s austerity policy. Solar panel installations dropped off a cliff in Germany, Italy, Greece, Spain and more, as the Eurozone wrongheadedly pursued macroeconomic policy of austerity. Politically, the EU was just as climate-friendly as it is today, but seven years of green investment were lost—which it now has to regain in the 2020s.

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<sup>1</sup> DR Thorpe, "What We Failed to Learn from Suez," *Telegraph*, November 1, 2006, <https://www.telegraph.co.uk/culture/3656288/What-we-failed-to-learn-from-Suez.html>.



*Solar panel installation dropped off a cliff in Germany, Italy, Greece, Spain etc as the Eurozone pursued ruinous austerity policy. (Source: SolarPower Europe)*

As it stands, Europe will not be able to achieve rapid decarbonization without relaxing its fiscal rules and vastly upgrading the EU budget with a common borrowing facility and its own tax raising powers. Currently only four EU countries—Denmark, Ireland, Malta, and Sweden—can meet their national climate goals without breaching the existing rules.<sup>2</sup> Europe therefore has an ambitious plan for decarbonization without the financing to get there.

The European Commission estimates that the EU will have to spend some €600 billion per year to achieve the objectives set in its “Fit for 55” climate policy package, including existing spending, which will have to come in part from public sources.<sup>3</sup> To achieve its decarbonization and climate goals, Europe will therefore need to loosen its fiscal rules. Politics however, is standing in the way. Deep and flawed perceptions of national interest, especially in countries with more “frugal” outlooks, will have to change in order for the plan to be implemented and for decarbonization to succeed. There are, however, some reasons for optimism. Today, unlike in the Eurozone debt crisis which followed the 2008 financial crash, European leaders are proving more flexible. In addition, the perception of geopolitical existential risks in Ukraine is helping to mobilize political will for more ambitious action. Indeed, over the past year, European countries have nationalized utilities—including in Germany—plowed money into green investments, and taxed the windfall profits of energy companies. Fiscal rules have now effectively been

<sup>2</sup> Sebastian Mang and Dominic Caddick, “Beyond the Bottom Line,” New Economics Foundation, April 28, 2023, <https://neweconomics.org/2023/04/beyond-the-bottom-line>.

<sup>3</sup> “Ajustement à l'objectif 55,” Conseil Européen (website), July 25, 2023, <https://www.consilium.europa.eu/fr/policies/green-deal/fit-for-55-the-eu-plan-for-a-green-transition/>.

suspended or bent for several years, and once-ridiculed policies like price caps have been experimented with across Europe. However, if real progress is to be sustained, such long-term fiscal obstacles will have to be permanently lifted. This challenge is key to the next European Commission's work program when it shepherds the new Multiannual Financial Framework (MFF), that began in 2001 and concluding in 2027.

Unlocking Europe's path to this new economy will require change in Germany. For real and sustained decarbonization, Berlin will have to allow joint mutual debt issuance on a large scale, modeled on the Next Generation EU (NGEU) Fund—a temporary economic-recovery response during the pandemic that includes green measures—and loosen its own domestic fiscal straightjacket. Germany, however, is so far keen to prevent further fiscal federalization. Having pledged a €200 billion energy package for its own citizens and companies, backed in part by new borrowing, the country is now insisting that it will oppose further joint EU debt issuance or any softening of fiscal rules that would enable other countries to raise debt.<sup>4</sup> This goes against loud calls from other member countries, the European Commission, and even the IMF for more joint debt issuance.<sup>5</sup>

Worse still, a strict constitutional rule prevents Berlin from running a budget deficit. This resistance is rooted in the *Schuldenbremse*, or debt brake, which Berlin circumvented in 2020 by invoking exceptional circumstances; every political party in Germany is arguing the rule cannot be modified and the new government has committed to return to in 2024.<sup>6</sup>

A more ambitious reform of fiscal rules than the one proposed by the Commission is both possible and necessary and is only achievable as part of a broader deal that includes reform of national fiscal rules, a larger EU budget, new taxes for the EU budget, and a clearer commitment to safeguard green investments.

Recently, however, the fiscal problem deepened when the EU decided to embark on a bold response to the US IRA and embrace green industrial policy. While greening industrial policy was an integral part of the EU's original green deal in 2019, the European Commission took time to change its doctrine on trade, competition policy, and state aid to make it viable. But the financing resources to underwrite this green industrial policy are limited at the European level, which means that it will be constrained or, even worse, will feed intra-European competition that is already visible between France and Germany on issues surrounding electricity-market reform and subsidies for the nuclear energy industry. Both countries have chosen different energy strategies and are concerned that the other will gain a structural competitive advantage over the other. As a result, Germany is obstructing efforts by France to subsidize its electricity generation via nuclear power and France is undermining Germany's attempt to subsidize energy prices for

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<sup>4</sup> "Germany's Parliament Approves 200 Billion Euro Fund to Tackle Energy Crisis," Reuters, October 21, 2022, <https://www.reuters.com/business/energy/germanys-parliament-approves-200-billion-euro-fund-tackle-energy-crisis-2022-10-21/>; and Guy Chazan and Sam Fleming, "Germany Rejects Push for Fresh EU Borrowing to Battle Energy Crisis," *Financial Times*, October 30, 2022, <https://www.ft.com/content/86b27da5-bc6c-49d0-af72-62f79c5c39b3>.

<sup>5</sup> Jan Strupczewski, "IMF Calls for EU Fiscal Capacity, Rules to Be Linked to Risk," Reuters, September 5, 2022, <https://www.reuters.com/world/europe/imf-calls-eu-fiscal-capacity-rules-be-linked-risk-2022-09-05/>.

<sup>6</sup> Shahin Vallée, Jérémie Cohen-Setton, and Dominik Buhl, "Germany's Debt Brake and Europe's Fiscal Stance after COVID-19," German Council on Foreign Relations, May 5, 2021, <https://dgap.org/en/research/publications/germanys-debt-brake-and-europes-fiscal-stance-after-covid-19>.

its energy-intensive sectors.<sup>7</sup> This turf-war is illustrative of the challenges of green industrial policy that is insufficiently Europeanized in its design and in its financing. It raises profound risks for its effectiveness and for internal European cohesion.

These challenges have only emerged recently and are therefore not addressed properly. Notably, the Fit For 55 legislative package—adopted in April and with all the elements in effect by the end of June—contains policies ranging from regulatory measures to taxes, both broadening and sharpening Europe’s green policy. It also encompasses trade policy, such as the new Carbon Based Adjustment Mechanism (CBAM) tariff to enable the EU to achieve a reduction of its emissions of 55 percent by 2023, compared to 1990. Still, the main shift on industrial policy really happened much later in 2023, as a result of Europe’s burning desire to fiscally respond in kind to the US IRA. The European climate policy is increasingly tentacular and ambitious, but it lacks financial firepower, unlike the US IRA’s potentially unlimited tax credits.

**Table 1: Europe’s Green industrial Plan**

		Green Deal Industrial Plan			
		Simplified regulatory environment	Faster access to funding	Enhancing skills	Open trade for resilient supply chains
	Loosening of state aid rules		X		
	Net Zero Industry Act	X		X	
	Critical Minerals Act	X			X

The panic over loss of competitiveness—for the green technology sector and more broadly for all energy-intensive industries and the electric vehicle (EV) sector—has caused an existential crisis in Europe that compelled fiscal action, but only at the national level. As a result, it is nowhere near enough to fully finance the transition. Positively, the EU has decided that the temporary state aid framework established during the height of Europe’s energy crisis will essentially relax constraints weighing on individual governments to support their green industries. In particular, the EU agreed to introduce “matching exemptions” to its state aid rules, which allow member states to match aid provided by a foreign country to European competition in order to maintain economic activity in their country.<sup>8</sup> These were steps encouraged by European corporations threatening to relocate their production to the United States, at the expense of their investment plans in Europe. Promisingly, these ideas were decided alongside a discussion about creating a European sovereignty fund to finance the green transition, which for

<sup>7</sup> “Ajustement à l’objectif 55,”

<sup>8</sup> “State Aid: Commission Adopts Temporary Crisis and Transition Framework to Further Support Transition Towards Net-zero Economy,” European Commission, March 9, 2023, [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_23\\_1563](https://ec.europa.eu/commission/presscorner/detail/en/ip_23_1563).

the first time was mentioned by Commissioners Breton and Paolo Gentiloni in October 2022.<sup>9</sup> The ambition was for this fund to become the primary fiscal resource for the EU's green transition—but it failed.

When Europe's Green Deal Industrial Plan surfaced in February 2023, the sovereignty fund had vanished, in large part as a result of a Faustian pact between President Macron and Dutch Prime Minister Mark Rutte,<sup>10</sup> involving a French concession to use currently available money and later work on a sovereignty fund. This effectively killed any effort to Europeanize the design and funding of Europe's green industrial plan. As a result, despite very ambitious targets set in the Net Zero Industrial Act for domestic production of electrolyzers, photovoltaics, or wind turbines, the EU is short of policies and funding for fiscal achievement of its green industrial revolution.

In sum, fiscal rules and austerity will politically undermine the EU, already in a technical recession. A recent paper on voting patterns finds that the "main economic explanation behind the populist vote in Europe is the economic performance of the region, measured as annual regional growth in GDP per capita." Center-left and center-right parties risk being swept away as they have in recent elections in Italy, Spain, Austria, and Greece. In theory, there's space to throw off ideological constraints, but with inflation the grip of fiscal hawks has tightened. No one should be shocked by a far right wave across the continent that will threaten the pace of decarbonization (and consequently any rosy projections of mineral demand)

## 2. THE HOSTAGE PROBLEM

### *Carbon-Intensive Industries Hold Parliaments Hostage*

European decarbonization risks being stalled or delayed by vested interests. This hostage problem, where powerful carbon-intensive industries can exercise undue influence over legislative or government agendas, is best exemplified by the stalling actions of the German automobile industry. Decisive action on decarbonization will require European politics to cut through this obstruction.

The German automobile industry's influence is visible on every autobahn, where you will see no speed limits. For decades, the nation's environment ministers have tried to pass autobahn speed limits, with the environmental agency estimating that a national speed limit of 130 kilometers per hour would reduce its carbon emissions by two million tons per year—yet action has proved impossible. The power of the automakers' lobbying group, Verband der Automobilindustrie (VDA), which vigorously opposed such speed limits, is credited for successfully blocking them. Earlier this year, the German government made a stunning reversal in its position on phasing out the combustion engine. After the EU celebrated an agreement in October 2022 to ban the sale of new internal combustion engine (ICE) vehicles in the EU by 2035, Germany single-handedly asked to reopen the legislative file and settle in March 2023 on a new agreement that effectively allows ICE to be sold beyond 2035 provided they run on "clean

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<sup>9</sup> Thierry Breton and Paolo Gentiloni, "Germany's Latest Response to Energy Crisis Raises Questions," *Irish Times*, October 3, 2022, <https://www.irishtimes.com/opinion/2022/10/03/germanys-latest-response-to-energy-crisis-raises-questions/>; "A European Sovereignty Fund for an industry "Made in Europe" | Blog of Commissioner Thierry Breton," European Commission, September 15, 2022, [https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT\\_22\\_5543](https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_22_5543).

<sup>10</sup> Clea Caulcutt, "Macron, Rutte Agree to Disagree on European Response to US Subsidies," *Politico*, January 30, 2023, <https://www.politico.eu/article/macron-rutte-agree-to-disagree-on-european-response-to-us-subsidies/>.

fuel” with stricter CO2 emissions. It is particularly striking that such corporate lobbying was allowed even under a Green coalition government.

### 3. THE COLLECTIVE ACTION PROBLEM

#### *Carbon-Intensive Regional Interests Hold Europe Back*

Europe’s political system hands huge influence to carbon-intensive regional interests. Because the EU is made up of individual states negotiating either with or through common institutions, this semi federalized system can turn carbon-intensive nations or regions into veto players or stallers who need to be placated at minimal cost to make progress. This state of affairs is the result of legacy national energy choices and the byproduct of geographical and mineral endowments. The case of the Polish coal industry is a perfect example of the collective action problem that repeatedly slows decarbonization.

Poland initially pushed against European decarbonization, in the strongest terms. “There is no plan to abandon coal in Poland,” President Andrzej Duda told statesmen at the 2018 United Nations climate conference in Katowice. “Coal is our strategic raw material. We have supplies for two hundred years and it is difficult for us to give up coal, thanks to which we have energy sovereignty.”<sup>11</sup> This strong feeling reflected the country’s resource base with coal powering over 70 percent of Poland’s electricity. This corresponds to strong regional and business interests inside the Polish political system, turning Warsaw into a staller.

Brussels, with money, thought it had the answer. However, this has come at the cost of deprioritizing other pressing issues. The Commission has offered Poland €3.9 billion of its specially created Just Transition Fund (JTF), created against the backdrop of the negotiations to create the European Green Deal, between 2019-2021. The JTF is specifically aimed at carbon-intensive regions that are heavily dependent on fossil fuel extraction, and the Commission hopes to financially induce them to embrace the transition. Then-European Commission Executive Vice-President Frans Timmermans noted in 2020: “As we rebuild our economies and our societies we will have to resist falling into the trap of rebuilding old structures. We simply cannot afford paying to go back to business as usual and then paying again to transform.”<sup>12</sup> In the case of Poland, Brussels initially sought to make the deal conditional on improvements regarding the bloc’s terms on rule of law. But in the end, the Commission was forced to drop these demands and hand over nearly a quarter of the fund to a single member state.<sup>13</sup> The energy crisis that followed Russia’s invasion of Ukraine stressed the coal phaseout plans in both Poland and Germany. While Poland is maintaining its current plan to close all coal mines by 2049, no new closures are expected to occur until 2033 at the earliest.<sup>14</sup> Germany, meanwhile, has a more ambitious plan to phase out coal by 2038, with a further goal of reaching it by 2030

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<sup>11</sup> Piotr Żuk and Kacper Szulecki, “Unpacking the Right-populist Threat to Climate Action: Poland’s Pro-governmental Media on Energy Transition and Climate Change,” *Energy Research & Social Science* 66 (August 2020), <https://www.sciencedirect.com/science/article/abs/pii/S2214629620300621>.

<sup>12</sup> “Speeches by EVP Timmermans, Commissioner Ferreira and Commissioner Simson at the Just Transition Platform Launch Event,” European Commission, June 29, 2020, [https://ec.europa.eu/commission/presscorner/detail/en/speech\\_20\\_1220](https://ec.europa.eu/commission/presscorner/detail/en/speech_20_1220).

<sup>13</sup> Alina Pogoda, “Poland May Irretrievably Lose Half of Its Funds for a Just Transition,” *Just Transition* (blog), March 23, 2021, <https://www.just-transition.info/poland-may-irretrievably-lose-half-of-its-funds-for-a-just-transition/>.

<sup>14</sup> Aleksandra Krzysztozek, “Poland to Slow Coal Phase-out Process, Maintain 2049 End-date,” *Euractiv*, November 8, 2022, <https://www.euractiv.com/section/energy/news/poland-to-slow-coal-phase-out-process-maintain-2049-end-date/>.

at the earliest, yet it restarted two coal power plants as a stopgap measure to make up for lower natural gas supplies from Russia.<sup>15</sup> This exposed the reality that the Just Transition Fund and the EU's coal phaseout commitments are going to be undermined if not abandoned altogether in the face of minimal transfers and geostrategic risks.

Energy has been a key thread in knitting Poland into the West and the European Union. Brussels needs to make the transition just as important and attractive—or risk having collective action stall attempts to make Europe green.

#### **4. THE JUST TRANSITION PROBLEM**

##### *Decarbonization Risks Public Backlash*

European elites risk the rejection of decarbonization by the electorate, particularly by an emerging coalition of industrial interests as well as those in lower social classes who rightly feel the weight of an unjust burden for the adjustment, while contributing the least to emissions. This is the risk exemplified by the 2018-2019 mass protests in France known as the *Gilets Jaunes*, known for their signature high-visibility yellow vests that are mandatory for drivers. Triggered by a carbon tax on fuel, the protest movement rocked the Macron government, forcing an about-turn and leading to a broader reluctance to advance decarbonization initiatives. Their most popular slogan—“Paradise for the rich, not a radish for the rest”—was a disaster for the framing of European decarbonization. European elites should worry about the *Gilets Jaunes* prefiguring a broader backlash: with the continent's poor already the most-energy burdened in terms of the percentage of income spent on fuel or with livelihoods immersed in carbon-heavy industries or work patterns, protest movements or populists could easily derail the rollout of regressive decarbonization. The loss of industrial jobs due to decarbonization would heighten this risk, providing a perfect alliance between corporate vested interests and poor workers. This is, in fact, what is already fueling a tacit alliance between far right populists and pro-business conservative parties, both of which are challenging the European Green Deal. They are together liable to become a central political force in the next European Parliament and even the Commission, and this has not been countered yet by an alternative policy package that can create broad societal support for decarbonization. Europe's climate transition therefore hangs on the ability to arrange a socially just transition to enlist broad popular support for a policy that is today highly regressive—when emissions are largely the result of privileged individuals and energy-intensive corporations.

European populists are building an arc of reluctance and consistently position themselves as climate skeptics. In Germany, the Alternative for Germany (AfD) has pitched itself as a pro-diesel party, opposing various phaseouts. This has proved a winning strategy for the party, which has won support in deindustrialized areas suffering from poverty, low investment, and population decline, and where decarbonization is sometimes viewed as a burdensome and imposed luxury. Tellingly, in the last European elections the AfD received the party's largest share of the vote in the coal-rich regions of Brandenburg and Saxony. This is part of a pan-European trend. In the Netherlands, Dutch populist and conservative parties have protested the ammonia tax imposed on the nation's livestock. In Italy, figures in the ruling hard-right League and Brothers of Italy coalition have denounced EU decarbonization policies as hurting both consumers and industries, with Deputy Prime Minister Matteo Salvini blasting EU green policies in 2022 as “a danger to the competitiveness of businesses and the lifestyle of Italian citizens.” In France, Marine Le Pen, who ran for president as the National Rally candidate in the last

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<sup>15</sup> Carolina Kyllmann, “German Coal Region Brings Phase-out Forward to 2030 but Refires Lignite Short-term,” *Clean Energy Wire*, October 4, 2022, <https://www.cleanenergywire.org/news/german-coal-region-brings-coal-phase-out-forward-2030-refires-lignite-short-term>.

election, is fighting against diesel taxes and for greater energy subsidies. The danger is therefore that these parties help crystallize an anti-climate policy coalition in the next European Parliament after June 2024. We are already seeing signs of this dynamic in the European Parliament with the highly contested passage of the Nature Restoration Law, which nearly failed due to an ad hoc alliance between the right and the far right.<sup>16</sup>

The socioeconomic risks inherent in the transition are not lost on European leaders. In the energy crisis of 2022, European governments chose to subsidize citizens' energy bills while also cutting fuel taxes on an enormous scale of between 1 percent and 10 percent of their GDP. EU member governments and the UK are estimated to have spent about €908 billion total in fiscal subsidies to offset the increases in fossil fuel prices.<sup>17</sup> Looking ahead, the European Council has pared its post-2025 plans for carbon pricing of fuels for transportation and homes with a newly created "social climate fund" that will distribute nearly \$60 billion to vulnerable households between 2025 and 2030.<sup>18</sup> What European leaders do not seem to be preparing is a permanent level of transfers to enable an effective transition.

## **5. THE INDUSTRIAL PROBLEM**

### *Industrial Policy is Hard*

Dirigisme is difficult, especially in more decentralized contexts where industrial interests are diverse, institutional structures and practices are different, and welfare models diverge. When it comes to decarbonization, European officials risk relearning several bad practices of the past that have long confounded industrial policy without addressing two emerging ones. Picking winners is hard and supply chain coordination is complex. Industrial policy needs to be European but national contexts and instruments will probably need to differ, thereby creating doubts about the level-playing field. This is only going to become more difficult with time as Europe's industrial base erodes in the context of higher and volatile energy prices in a changing climate landscape.

Europe's challenge of an eroded industrial base is well illustrated by the state of the French nuclear industry or the decay of the German auto sector in the EV space. These are both creating existential industrial crises and fueling industrial policy reactions that are actually undermining cooperation rather than fueling a shared European industrial policy.

Successful industrial policy is fraught with the issue of coordination, which is only made deeper in the European context. The sheer complexity and interconnectedness of decarbonization requires the state to drive this, but the EU doesn't have the full prerogatives of an economic planner and has often been forced to concede to the ambitions of individual member states. The task of greening electricity, transport, industry, buildings, and agriculture simultaneously is an immense challenge, and treating problems and bottlenecks in isolation rather than holistically makes matters worse. And the more siloed the approach, the slower the process. The Net Zero Industrial Act is a case in point: it sets a number of extremely ambitious objectives for

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<sup>16</sup> Ajit Niranjana, "EU passes nature restoration law in knife-edge vote," *The Guardian*, July 12, 2023, <https://www.theguardian.com/world/2023/jul/12/eu-passes-nature-restoration-law-vote-meps>.

<sup>17</sup> Colgan, Gard-Murray, and Hinthorn, *Letting Europe's Energy Crisis Go to Waste*, 2.

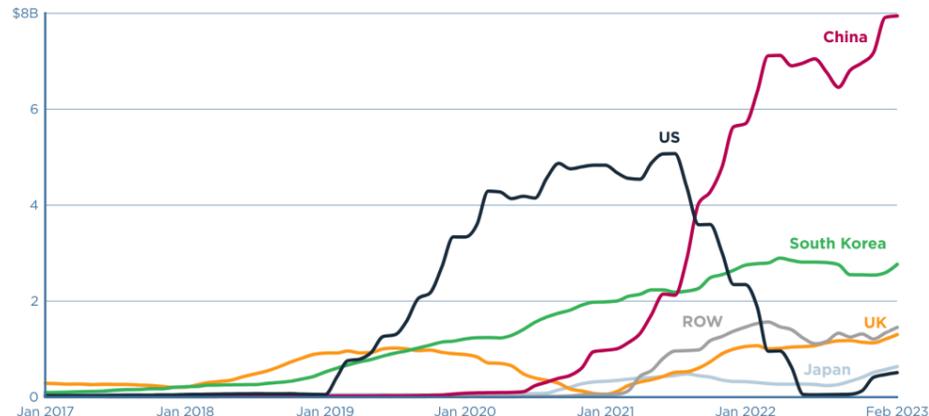
<sup>18</sup> "Deal on establishing the Social Climate Fund to support the energy transition," European Parliament, December 18, 2022, <https://www.europarl.europa.eu/news/en/press-room/20221212IPR64528/deal-on-establishing-the-social-climate-fund-to-support-the-energy-transition>.

Europeanizing supply chains in green technologies (e.g., PV panels, electrolyzers, wind turbines) but lacks the policy tools and fiscal resources to achieve these targets.<sup>19</sup>

Illustratively, EU policies meant to encourage widespread EV adoption have already had unintended consequences to the detriment of European sovereignty. In 2021, the EU's Fit for 55 package included a date banning new ICE vehicles in Europe in 2030, as mentioned above. But the EU, lacking proper financing for its transition arrangement, failed to give European automakers incentives and to set up European supply chains. Consequently, a large number of these companies moved EV production to China, where such supply chains are much better established and costs are lower. The result: a surge of Chinese EV exports to Europe—driven by EU companies. German automotive foreign investment accounted for a third of all European foreign investments in China from 2018 to 2021, the period of the European Green Deal's introduction. By 2021, German automotive companies' investments accounted for 42 percent of EU foreign direct investment in China, and Chinese EV imports to the EU totaled approximately \$8 billion in value.<sup>20</sup>

#### The EU used to import electric vehicles from the US but now mostly imports from China and South Korea

Value of EU electric vehicle imports, 12-month trailing sums, billions of USD, 2017-23 (year to date)



ROW = rest of world

Notes: The CN codes are 87038010 and 87038090 in 2017-23 and 87039010 in 2016. Trade values are converted to US dollars from euros using end-of-month USD/euro spot exchange rates from Federal Reserve Economic Data (DEXUSEU).

Source: Eurostat.

Source: PIIIE

<sup>19</sup> Zsolt Darvas and Guntram B. Wolff, "A Green Fiscal Pact for the EU: Increasing Climate Investments while Consolidating Budgets," *Climate Policy* 23, no. 4 (2022), <https://www.tandfonline.com/eprint/SUUCT4V5EFIKFRPUEWSD/full?target=10.1080/14693062.2022.2147893>.

<sup>20</sup> Elettra Ardissino (senior analyst, Greenmantle), interview with the authors, August 9, 2023; Gregor Sebastian, "The Bumpy Road Ahead in China for Germany's Carmakers," Mercator Institute for China Studies (think tank), *MERICs China Monitor*, October 27, 2022, 5, [https://merics.org/sites/default/files/2023-02/MERICs\\_China\\_Monitor\\_No79-Automotive-RD-in-China\\_EN.pdf](https://merics.org/sites/default/files/2023-02/MERICs_China_Monitor_No79-Automotive-RD-in-China_EN.pdf); "European Investment in China Concentrates More on Handful of Large Firms: Report," Reuters, September 14, 2022, <https://www.reuters.com/markets/europe/european-investment-china-concentrates-more-handful-large-firms-report-2022-09-14/>; and Chad P. Bown, "Working Paper 23-1: Industrial Policy for Electric Vehicle Supply Chains and the US-EU Fight over the Inflation Reduction Act," Peterson Institute of International Economics, May 2023, 20, <https://www.piie.com/sites/default/files/2023-05/wp23-1.pdf>.

Resolving these five issues are critical. Chief is the fiscal problem. At the highest level of leadership, there are signs of openness to deep change. German Chancellor Scholz argued in favor of adopting majority voting for issues of foreign policy and taxation in EU policymaking, noting that the EU would need to reform in the changing transatlantic security environment.<sup>21</sup> It is therefore incumbent that spending decisions could and should be taken under qualified majority, and that the budget should be voted at the beginning of every new Commission and EU Parliamentary term with greater annual flexibility. This would require bold action from the next European Commission at its inception in the summer of 2024 and should already be a topic of discussion in European election campaigns.

### **POLICY RECOMMENDATIONS INSIDE EUROPE:**

- EU members must abide by the 2030 carbon emission targets set out under the European Green Deal and the REPowerEU plan. This will require greater funding and public-private investment commitments into clean energy infrastructure across multiple sectors by all EU members.
- Reform EU fiscal rules such that public spending for decarbonization-related investments and development are not curtailed. Align energy and transition plans to national fiscal plans and EU to ensure coherence through multilateral surveillance.
- Reform the EU budget process to be based on qualified majority voting instead of under the current system of unanimous consent for spending and ensure that sufficient funds are allocated to the climate and energy transition.
- Reform EU tax policies so as to grant partial and limited autonomous taxing capacity for the EU budget (e.g., corporation tax, value-added tax, plastic tax, CBAM).
- Scale up the EU budget to triple its current size for the coming seven-year period (2027-2035) so that any post-European Green Deal decarbonization commitments can be correspondingly increased in scope.
- Provide funding for the long-term reconstruction of Ukraine into a green economy.
- Provide funding for a mass program of training skilled specialists for the transition.

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<sup>21</sup> Oliver Noyan, "Scholz Pushes to Strengthen EU's Ability to Fight Rule of Law Violations," *Euractiv*, May 9, 2023, <https://www.euractiv.com/section/eu-reforms/news/scholz-pushes-to-strengthen-eus-ability-to-fight-rule-of-law-violations/>.