About the report?

Freedom can remarkably transform societies, lifting billions out of poverty and ushering in technological advancements previously deemed impossible. It also holds the potential to slow the rise in global temperatures. However, we must remove the regulations restricting it to achieve this. Data shows that the freer the economy, the faster decarbonization.[1] This principle is the core message of our report, which builds on Nick Loris's research in "Free Economies are Clean Economies."[2]

At the Warsaw Enterprise Institute's initiative, researchers from think tanks in Poland, Czechia, Slovakia, Bulgaria, Romania, Hungary, and Ukraine have identified the barriers facing private companies in the broadly defined energy sector. These barriers include bureaucracy, regulations, mandates, subsidies, perverse tax policies, state ownership, and interventions like price caps or artificially created markets such as the Emission Trading System (ETS). Rooted in national and EU policies, these obstacles must be removed, reduced, or redesigned to achieve a zero-carbon economy. However, eliminating barriers alone is not enough. We must also create the right incentives for capital to flow in the desired direction. To this end, our report draws on the Climate & Freedom Accord, a proposal for an international free market agreement on climate and sustainable development, which emerged from working groups convened by members of the Climate & Freedom International Coalition.[3],[4]

The challenge: free market v climate policies

The challenge of climate change is significant, as evidenced by the current per capita GHG emissions in these countries: 8.1 tons per year in Poland[5], 9.3 tons in Czechia, 6.1 tons in Slovakia, 6.8 tons in Bulgaria, 3.7 tons in Romania, 4.4 tons in Hungary and 3.6 tons in Ukraine. Achieving a zero-carbon economy will be more challenging for these nations than wealthier countries, as they are still among the poorer parts in Europe when measured by GDP per capita. A green economy should encompass not only reduced CO_2 emissions but also cleaner air, water, forests, and more sustainable use of natural resources.

Unfortunately, the EU climate policy is formulated in a way that does not sufficiently consider the ability of the free market economy to go green and reduce CO_2 emissions into the atmosphere.

There is no denying that climate policies place a strong emphasis on investment in clean technologies. However, they often do so in the wrong way, or at least in a suboptimal way, based on the belief that it is up to the government to identify the desired investments and then

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[1] Bjørnskov, Christian, *Economic Freedom and the CO_2 Kuznets Curve* (January 8, 2020). Available at SSRN: https://ssrn. com/abstract=3508271 or http://dx.doi.org/10.2139/ssrn.3508271 "The available data from 155 countries observed in five-year periods between 1975 and 2015 indicate that economic freedom not only reduces overall CO_2 emissions but also shifts the top point of the EKC to the left. As such, the evidence suggests that the transition to lower emissions technology appears at an earlier stage in economically free societies."

[2] Loris, Nick, 2021. "Free Economies are Clean Economies: A study of the correlation between economic freedom, limited government, open markets, private property rights, and environmental performance around the world." Available at: https://www.c3solutions.org/wp-content/uploads/2021/04/Free-Economies-Are-Clean_Economies.pdfment,

[3] https://cleantaxcuts.org/wp-content/uploads/climatefreedomaccord-straw-230202.pdf.

[4] https://cleantaxcuts.org/wp-content/uploads/cfic-bullets-eng-v3-2pg-240321.pdf

[5] Data for all the countries mentioned: *Per capita CO_2 emissions,* https://ourworldindata.org/grapher/co-emissions-per-capita (accessed 28.05.2024).

finance them preferentially. This arbitrary choice distorts the market allocation of capital, directing it not where it will yield the highest return, but where officials want it. Meanwhile, the simple observation that is the starting point of our report is that lowering the cost of new investment increases the tendency to deploy the latest technologies more quickly. These technologies, in turn, tend to be cleaner and more efficient.

Drawing from diverse perspectives across Central Europe, the insights presented show the critical need for a paradigm shift from government-driven mandates to a more liberalized market environment that can naturally evolve to meet the demands of today's economy and tomorrow's environment.

General overview: what have we found?

The CEE countries covered by this report have generally less ambitious CO_2 emission reduction targets than Western European countries. However, the CEE countries may struggle to meet these modest targets. The struggle to meet the climate goals is partially caused by the infrastructure neglect and worsening market for private investments.

The infrastructure neglect is one of the biggest obstacles to the functioning of the expected energy market. It reduces the ability to scale businesses, and locks business models within national boundaries, facilitating the creation of oligopolies. Interconnections in the CEE region alone account for only 13 percent of the EU's internal interconnection capacity.

Importantly, it is estimated that at least $100 billion annually has to be invested into clean energy R&D to avert the negative impact of climate change. Private investments are crucial. Currently, 77 percent of companies from Central and Eastern Europe report investing in business development, with private funds accounting for nearly 70 percent of all renewable energy investments. Whilst the private investments are crucial, the climate for such investments is substantially worsening in the surveyed CEE countries. The investment-to-GDP ratio is below the EU average for all countries except Hungary. At the same time, economic freedom is generally declining whilst there is increasing pressure on public investment.

To tackle this challenge, we have identified 40 different barriers to investment in the energy sector of selected CEE countries. The most common obstacles include

- bureaucracy,
- state control,
- regime uncertainty,
- revenue constraints,
- limited access to the grid,
- limited access to land,
- unfair government procurement practices, and
- high taxes.

Among the analyzed countries, Czechia and Romania are the most open, while Hungary and Bulgaria face challenges in nearly all identified categories.

The impact of EU policies on private investment levels in CEE countries is contradictory. While the EU promotes market openness and integration, it also allows market-distorting programs.

Additionally, the EU's Carbon Border Adjustment Mechanism (CBAM) tax on the carbon footprint of imports is expected to reduce the profitability of investments.

Based on the report, in this paper, we take a closer look at **Ukraine.**

Ukraine in light of other countries

Ukraine produces 'only' 3.6 tons of GHG emissions per capita, in contrast to 8.1 tons per year in Poland, 9.3 tons in Czechia, 6.1 tons in Slovakia, 6.8 tons in Bulgaria, 3.7 tons in Romania, 4.4 tons in Hungary. However, the challenge is still significant for Ukraine and the region. In terms of policy, Ukraine's market liberalization is a recent and ongoing development, complicated by war-related expenditures. Despite these challenges, foreign actors are expected to play a crucial role in Ukraine's energy transition, bringing in necessary investments and expertise.

Regarding the energy production, Ukraine, if it joins the EU, would benefit from its 15 operating nuclear reactors, which provide 55 percent of its electricity. In comparison, Slovakia's five nuclear reactors supply 59 percent of its electricity, with new capacity recently added. Hungary's single nuclear power plant, with four reactors, produces 44 percent of its electricity. Based on numbers, Ukraine would have the largest number of nuclear reactors within the CEE region.

Yet, the ongoing war has devastated the country, with rebuilding costs reaching astronomical levels. Despite these challenges, Ukrainians remain determined to achieve peace and pursue EU membership and a green transition. Therefore, Ukraine has made notable progress in reducing bureaucracy, especially following the Russian invasion in 2022. The country has implemented digitized procedures, reduced inspections, and offered tax exemptions for significant investment projects, supporting economic activity and improving clean technologies. Restrictions on certain energy activities, often due to environmental or security concerns, are generally temporary and heightened during martial law. These restrictions primarily affect activities requiring special licenses or permits. Importantly, Ukraine's temporary restrictions highlight the need for flexible policies that adapt to changing circumstances.

There are, however, serious challenges and restrictions that limit Ukraine's capacity to adopt an efficient energy policy. During martial law, Ukraine imposed restrictions on capital flows out of the country, affecting private individuals and commercial entities. By lifting these restrictions, Ukraine can provide more stability and predictability for investors, which is crucial for attracting private capital in the energy sector.

Furthermore, Ukraine's efforts to simplify grid connections and involve local communities have been hampered by the ongoing conflict, which diverts resources needed for infrastructure rebuilding. Despite the electronic services introduced in 2021, access to the grid remains a challenge due to damaged infrastructure.

In Ukraine, access to land for renewable energy projects has been simplified by recent legislation. The Land Code of Ukraine allows leasing land without changing its use, but Russia's aggression has introduced new risks and pollution, complicating land access. Under martial law, the public cadastral map is closed, affecting transparency.

Finally, Ukraine faces instability in tax legislation, with segmentation by mode of taxation creating potential loopholes and ambiguities.

Other countries in CEE region, such as Poland, Hungary and Bulgaria, experience similar limitations. However, the Ukrainian case is significantly more complex and challenging due to the ongoing war. In light of these, in the next section with propose specific and targeted policy proposals for Ukraine.

Policy proposals

Below we present policy proposals in three section: first, country specific proposals, second, region specific proposals, and finally, proposals for the whole EU.

i. Policy Proposals for Ukraine after the war.

Below, we present specific policy proposals for Ukraine after the war.

1) End War-Time Trade and Investment Restrictions:

Objective: Restore economic openness and encourage foreign investment. Eliminating all restrictions imposed during the war will signal Ukraine's commitment to revitalizing its economy and attracting international investors.

2) Introduce Regulatory Stability:

Objective: Provide a predictable and favorable business environment. Establishing stable regulatory frameworks will instill confidence among investors and businesses, nurture long-term economic growth and development.

3) Enhance transparency and access to public information:

Objective: Promote accountability and trust in governance. Increasing transparency in decision-making processes and providing easier access to public information will empower citizens, strengthen government accountability, and reduce corruption.

4) Remove Public Service Obligations (PSOs) burdening companies:

Objective: Improve financial stability and technical conditions of energy facilities. Liquidating PSOs will relieve companies of onerous obligations, enabling them to allocate resources more efficiently towards infrastructure maintenance and upgrades, ultimately enhancing energy sector performance. Liquidation of the Resolutions[1] under which the maximum price level for natural gas and electricity is maintained. These resolutions should be temporary measures to protect end consumers from price volatility and resource shortages during the war.

5) Abolish resolutions maintaining maximum price levels for natural gas and electricity:

Objective: Phasing out these price controls signals a shift towards market-driven pricing mechanisms. While initially necessary during wartime to shield consumers from volatility, they now hinder market dynamics and competitiveness. Embracing market-based pricing strengthens efficiency and ensures a fair allocation of resources.

6) Eliminate price caps hindering investment and import access:

Objective: Removing price caps facilitates investment decisions by creating a more transparent and competitive market environment. It also encourages energy imports, enhancing market integration and diversification. By aligning with international standards, Ukraine positions itself for greater efficiency and competitiveness in the global energy landscape.

ii. Policy Proposal for the CEE region

For the whole CEE region, we propose a proactive solution: the countries of the CEE region should lead by example, implementing market-oriented reforms first. They should do this jointly by concluding the "Pact for Freedom," an agreement that coordinates goals and tools. The aim would be to create a coherent, interconnected energy ecosystem based on EU guidelines for reducing CO_2 emissions, employing non-restrictive regulations and tax solutions outlined in the Climate and Freedom Accord. This initiative would establish a common free energy market for at least 110 million people.

By implementing the Freedom Pact, CEE countries can demonstrate the benefits of market-oriented reforms and create a more flexible and competitive energy market. This initiative would serve as a model for EU policymakers, showcasing the potential for economic growth and environmental sustainability through less restrictive and more efficient regulatory frameworks.

The Pact for Freedom should be founded on the proposals in The Climate & Freedom Accord. Some CEE countries already have solutions aligning with these proposals, although they often remain incomplete or inconsistently applied across companies seeking to invest in property, plant, and equipment (PP&E) or research and development (R&D). Our goal is to create an environment where bureaucratic complexities do not impede investments in innovation and modernization.

To develop the Pact's content, a series of workshops should be organized for regulators and legislators from each country. These workshops will provide opportunities to explore alternative ways to reduce CO_2 emissions, compare legal and tax systems, and determine actionable steps.

Key Provisions of the Pact for Freedom

For the Pact to be effective, it should include the following key provisions:

- Optimal tax levels: Set and harmonize existing taxes (mainly CIT and VAT) at the lowest feasible levels, ensuring they are as similar as possible across signatory countries.
- Eliminating market-distorting subsidies: Commit to phasing out subsidies that distort the market, creating a level playing field for all companies.
- Reduction of bureaucratic and regulatory barriers: Oblige countries to revise and streamline bureaucratic and regulatory procedures, reducing barriers to investment.
- Allocation of EU Funds: Ensure EU funds are allocated primarily to infrastructure investments that expand the market and enhance energy interdependence among signatories.
- Rollout and integration of enabling technologies: Accelerate the deployment of smart meters, facilitating grid monitoring and consumer empowerment.

- Addressing energy poverty: Link energy transition initiatives to addressing energy poverty, moving beyond temporary fixes to design long-term structural solutions that empower energy-poor households to become active consumers and benefit from sustainable energy systems.
- Mutually recognized tax and financial mechanisms: Introduce harmonized tax and economic incentives, such as accelerated depreciation and CoVictory Bonds, to strengthen investments in the broad energy sector.
- Evaluation and Monitoring: Implement a robust system for evaluating and monitoring the effects of the Pact's objectives, ensuring accountability and continuous improvement.

The Pact for Freedom would create a uniform Special Economic Zone (SEZ) across CEE countries, attracting more investments and capital. This initiative aligns with the Three Seas Initiative, which aims for a closer economic cooperation among 13 CEE countries. CEE is already emerging as a "nearshoring" hub for business services and manufacturing as industries rethink their global supply chains after COVID-19. Notably, CEE countries took six of the top seven spots in the 2020 Nearshoring Index from Savills[6], highlighting the region's economic growth and investment potential.

The successful acceleration of decarbonization in CEE countries, driven by free market principles, has the potential to inspire other regions and countries. The original Climate & Freedom Accord (CFA), developed by experts from global think tanks, is limitless in its applicability. Creating an international framework that guarantees economic freedom is essential for achieving faster economic development and secure environmental protection worldwide.

iii. Policy Proposal for the EU

The EU should reconsider its current climate policies, such as the Emissions Trading System (ETS), Carbon Border Adjustment Mechanism (CBAM), and Environmental, Social, and Governance (ESG) criteria. While these regulations aim to mitigate climate change, they impose substantial burdens on companies, affecting their resources and increasing operational costs. To address these concerns, the EU should explore more flexible and cost-effective approaches that achieve environmental goals without disproportionately impacting economic performance.

The financial demands of the energy transition are significantly higher than the funds currently allocated by the EU. This discrepancy is particularly challenging for CEE countries, which struggle to meet the ambitious targets set by the EU's Net-Zero Industry Act and the Critical Raw Materials Act. The EU should reassess its funding strategies, ensuring that the financial support provided is commensurate with the estimated costs of the transition.

The energy transition in the CEE region must acknowledge the historical reliance on coal energy and the unique economic conditions of these countries. Imposing uncompromising political decisions without considering these factors can hinder progress. Instead, the EU

[6] Poświata, J. Szreder, P., Kozub, P., Bobrowska, M.,Kolesnik, E., Swieboda, T. and Ćwikiewicz, M., November 15, 2022, *Private Equity and Venture Capital in Central and Eastern Europe Private investments in Central and Eastern Europe are ready to ride the rising tide of growth, fuelled by strongly performing economies and broad talent pools*, https://www.bain.com/insights/private-equity-and-venture-capital-in-central-and-eastern-europe/ (accessed 2024).

should promote flexibility and economically optimal solutions tailored to the specific needs of the CEE region. This approach will facilitate a smoother transition and ensure that all areas benefit equitably from the energy transition.

We recommend:

- Phase-out of the ETS mechanism. The ETS market has become unstable and highly unpredictable. While it contributes to reducing CO_2 emissions, its impact is overstated due to carbon leakage. This is not enough to achieve the desired goals. Further, it contributes to uncompetitiveness, deindustrialization, and offshoring emissions because it uses negative incentives that impose costs on the EU economy. In the short term, we recommend that any tightening of emission targets by the European Commission be discussed with member states well in advance rather than adopted in haste and in conjunction with large money transfers. This creates a temptation for politicians to approve even unachievable targets. In the long term, we recommend reevaluating the ETS as such and considering replacing it with the mechanisms described in this paper, such as Clean Tax Cuts and CoVictory Funds. The EU should incentivize its members to support policies that positively incentivize economic actors by creating more freedom to act, not by erecting barriers to "steer" them in a government-determined direction.
- Climate targets should focus on reducing emissions, where the development of renewables is only one of the many ways to achieve this goal. More comprehensive discussions around targets for the share of RES should be opened, and the proposed solutions should be flexible, as enforcing them requires economically suboptimal decisions from some countries (like Slovakia). Indeed, emission targets should be based on final consumption (including imports), not production. The function of the climate target should also be reconsidered. It should be treated as assessing what is feasible at a given time and cost rather than as a rigid target that must be met no matter what.
- The European Commission should not relax state aid rules any further. The regulatory capture should be prevented. Recent relaxations aimed at competing with the US's Inflation Reduction Act (IRA) demonstrate a misunderstanding of market economies, viewing them as zero-sum games rather than win-win environments. State aid channelled to specific industries and companies benefits some at the expense of others, distorting competition. The EC should protect the market from discretionary and disruptive political decisions. Achieving shared European goals requires market-driven solutions rather than flooding the market with taxpayer money.
- The EU should push countries to introduce policies that enable the expansion of interconnectors and mutual energy trade. Building a network of energy interconnections across the continent allows everyone to produce and sell energy regardless of geographic location. The EU should improve coordination between national grid operators to advance demand-side flexibility and integrate it into national strategies. Dedicated terms should be offered to small and local players, such as energy communities, active consumers, and SMEs, who might struggle with competitive grid access procedures to further decentralization. The same applies to flexible services like storage and demand-side response.
- Stopping CBAM implementation. The climate benefits of the Carbon Border Adjustment Mechanism (CBAM) will be minimal, while the costs of doing business and

the burden on European consumers will be high. CBAM is a protectionist tool that can politically fragment global relations and escalate conflicts. The EU should seek alternative methods to address carbon leakage that do not impose significant economic costs and political tensions.

- The EU should become a functional platform to share the best practices. Instead of a source of more regulation, the EU should become a place to exchange information about challenges and solutions and embrace best practices for successful grid administration, planning, regulation, and stakeholder engagement.