

Divergent climate policies to drive a chaotic transition



From the Field



Maria Elena Drew
Head of Global Sustainability

Executive Summary

February delivered two divergent climate-policy decisions: the European Union (EU) strengthened its long-term decarbonization trajectory by adopting a legally binding 2040 greenhouse gas (GHG) reduction target, while the United States (U.S.) moved to unwind the central legal foundation for federal GHG regulation.

The European Parliament amended the EU Climate Law to set a 2040 target of a 90% reduction in GHG emissions versus a 1990 baseline. The amendment did not pass without friction and has resulted in additional flexibility in how the EU meets its net zero target that includes a limited use of carbon credits and biennial reviews that can adjust implementation in light of energy prices, competitiveness, and technological progress.

In the same week, the U.S. repealed the Endangerment Finding, which is the scientific determination made by the Environmental Protection Agency (EPA) that carbon dioxide and other greenhouse gases endanger human health and the natural world. Concurrently, the EPA repealed existing vehicle GHG standards. Because the Endangerment Finding has

underpinned the use of the Clean Air Act for economy-wide GHG regulation, further regulatory rollbacks across high-emitting sectors are expected to follow.

Despite their policy divergence, both the EU and U.S. face the same underlying energy trilemma—balancing sustainability, security of supply, and affordability—and right now, both are feeling pressure on security of supply and affordability. This growing emphasis on energy security and affordability is likely to accelerate investment in energy efficiency, grids, flexibility, storage, renewables and nuclear power. In Europe, relatively stable energy policy and high natural gas prices have been a reinforcing mechanism toward these technologies, which we expect to continue. However, the U.S. outlook is more complicated. We expect the power generation mix will continue to trend greener over time (but at a slower rate than Europe), as we believe underlying economics will drive a “more of everything” approach to meeting growing electricity demand. However, decarbonization of the transport sector will likely be highly challenged.

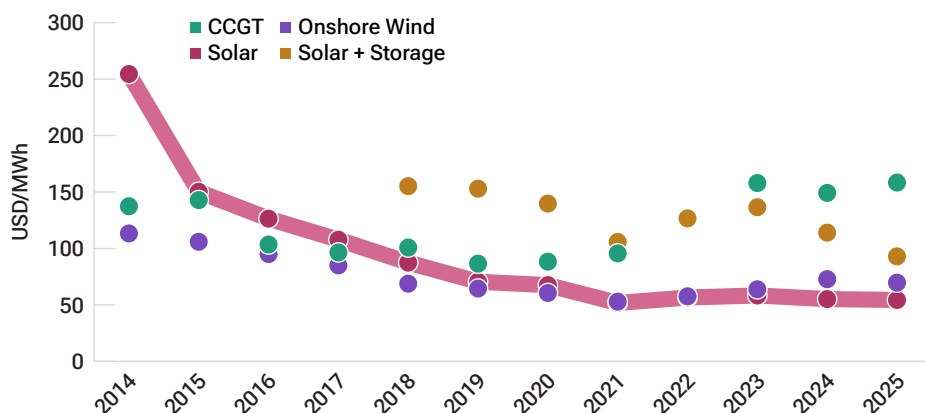
Different policy paths point to a bumpier transition

These February policy decisions should be interpreted against a backdrop in which the drivers of the energy transition are shifting. In many markets, renewable power has moved down the cost curve and is increasingly competitive on an unsubsidized basis. As a result, policy is no longer the only—or even the primary—driver of renewables deployment. However, the presence of a stable energy policy is still extremely important to ensuring stable and sustained investment in energy infrastructure (whether it is zero-carbon or fossil). Both the EU and U.S. have aging power plants and grids, and renewing this energy infrastructure will be an important element of economic competitiveness for both.

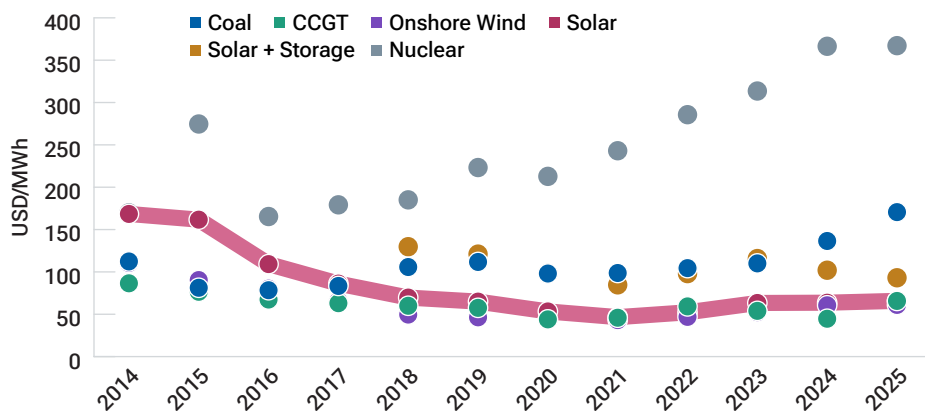
The levelized costs of electricity (LCOE) for renewables have decreased

(Fig. 1)

Germany



United States



Most recent data available as of February 2026. Note: The midpoint of the LCOE range is used (unsubsidized). CCGT = combined-cycle gas turbine. One USD/MWh, or dollars per megawatt-hour, is a unit of measurement that represents the cost of electricity. It specifically indicates how much it costs, in U.S. dollars, to produce or consume one MWh of electricity. Note: LCOE represents the average total cost of building and operating a power plant over its lifetime, expressed as a cost per unit of electricity generated (e.g., USD/MWh). LCOE enables standardized comparison across different power generation technologies (e.g., solar, wind, nuclear, natural gas) to help determine which ones are most cost-competitive. LCOEs are estimated because they are calculated using projected costs, capacity assumptions and financial assumptions over a plant's expected lifetime, rather than reflecting historic data. LCOEs are reported without subsidies or tax credits. For solar data, Photovoltaic (PV) fixed-axis is used due to its broader global data availability. For the U.S. chart, for 2025, the LCOE for CCGT and solar PV is estimated to be equal at \$66/MWh. Source: BloombergNEF.





Having a stable energy policy can also contribute to energy security—a concept that extends beyond the need to have molecules and electrons available today to ensuring reliable and affordable access to energy over decades. For both the U.S. and EU, energy security has re-emerged as a dominant political objective, shaped both by geopolitics and the race to secure sufficient, reliable electricity supply for artificial intelligence (AI) and data-center growth.

Given this backdrop, both the EU and U.S. would benefit from stable energy policies. While the additional flexibility included in the EU Climate Law amendment does introduce some uncertainties, we believe these will mostly center around decarbonizing hard-to-abate sectors. We expect that drivers underpinning the four largest areas of emissions (Figure 2) will remain intact (or at least largely intact). On the other hand, the U.S. repeal of the Endangerment Finding will most likely lead to a near-term removal of GHG emissions regulation; it will also probably lead to a drawn-out litigation process.

“ Having a stable energy policy can also contribute to energy security.

Where things are heading: Comparing the EU and U.S energy transition trajectories

(Fig. 2)

	EU 27	U.S.
 Power Generation	Energy security risk should drive mix toward renewables and nuclear... <ul style="list-style-type: none"> – Renewables and grid reinforcement to drive continued greening of power mix – Longer term, nuclear power should see capacity expansion in parts of Europe 	More of everything... <ul style="list-style-type: none"> – Changes in Clean Air Act could allow legacy coal plants to stay on for longer – Expect attractive economics of renewables to drive continued capacity expansion – Longer-term, nuclear power should see significant capacity expansion
 Transportation	Continued acceleration of electric vehicle (EV) sales... <ul style="list-style-type: none"> – EVs, plug-in hybrid EVs (PHEVs) and hybrids accounted for 61% of new car sales in 2025¹ 	Repeal of GHG standards will slow EV adoption... <ul style="list-style-type: none"> – Changes to the Clean Air Act will likely reduce EV sales, which are already low compared to the global baseline
 Buildings	Continued steady shift to electrification... <ul style="list-style-type: none"> – The combination of high natural gas prices, government incentives and carbon taxes are driving more heat pump adoption 	Slower shift to electrification... <ul style="list-style-type: none"> – Higher electricity prices may slow heat pump adoption in the U.S.
 Industry	Expect slower decarbonization after EU Climate Amendment... <ul style="list-style-type: none"> – High energy prices to incentivize energy efficiency investment – Carbon taxes to incentivize decarbonization efforts; however, we expect leniency on select industries to encourage competitiveness 	High energy prices should drive efficiency gains <ul style="list-style-type: none"> – High energy prices to incentivize energy efficiency investment – Over time, AI could help with efficiency gains

¹ European Federation for Transport and Environment.

U.S. regulation of GHGs may be on ice for a long time

On February 12, the EPA rescinded the Endangerment Finding and simultaneously repealed existing vehicle GHG emissions standards. The immediate effect is to remove a key legal basis that supported a wide set of federal climate rules under the Clean Air Act. The administration's rationale is framed primarily in legal terms rather than as a challenge to climate science.

In practice, these actions are likely to trigger prolonged legal disputes and the repeal could operate as a de facto policy freeze during years of litigation. It could also raise the risk that future administrations would need to rebuild both the scientific record and the legal case to re-establish federal GHG regulation.

Unlike the EU, the U.S. has never passed any form of comprehensive climate or GHG emission legislation. Instead, it has relied on legal precedent to allow agencies to regulate GHG emissions or, in the case of the Biden administration's marquee climate initiative (the Inflation Reduction Act or "IRA"), the reconciliation process, which only relies on majority vote and is therefore easier to repeal.

As the Supreme Court has not historically shown interest in removing the Endangerment Finding when ruling on related cases, the EPA's regulatory action is in essence inviting the Supreme Court to come in and make a "landmark" ruling. Given the change in its composition, the current court may be a more sympathetic audience for the administration's case than previous ones.

While it is still too early to understand how companies will react to this new regulatory shift, the U.S. energy market is dominated by the need to meet growing electricity demand affordably. The most binding security-of-supply question is increasingly about electricity and whether the system can reliably meet rising demand from AI and data centers. This helps explain why affordability, reliability, and permitting have become central to policy debates, and why a rollback of federal climate rules does not necessarily translate into a slower build-out of infrastructure enabling electrification.


The EU doubles down on its climate agenda (sort of...)

On February 10, the European Parliament amended the EU Climate Law to establish a legally binding 2040 target: a 90% reduction in EU-wide GHG emissions versus a 1990 baseline. The EU Climate Law (adopted July 2021) already set a 2050 net-zero objective and a 2030 interim target of at least -55% versus 1990. This amendment fulfilled the law's requirement to set a 2040 target.

Parliamentary negotiations introduced additional flexibility in implementation. The amendment allows the use of carbon credits to contribute up to 5% of the 2040 target after 2036. It also requires biennial progress reviews, with scope for adjustments based on scientific evidence, energy prices, competitiveness, technological progress, and the scale of net removals.

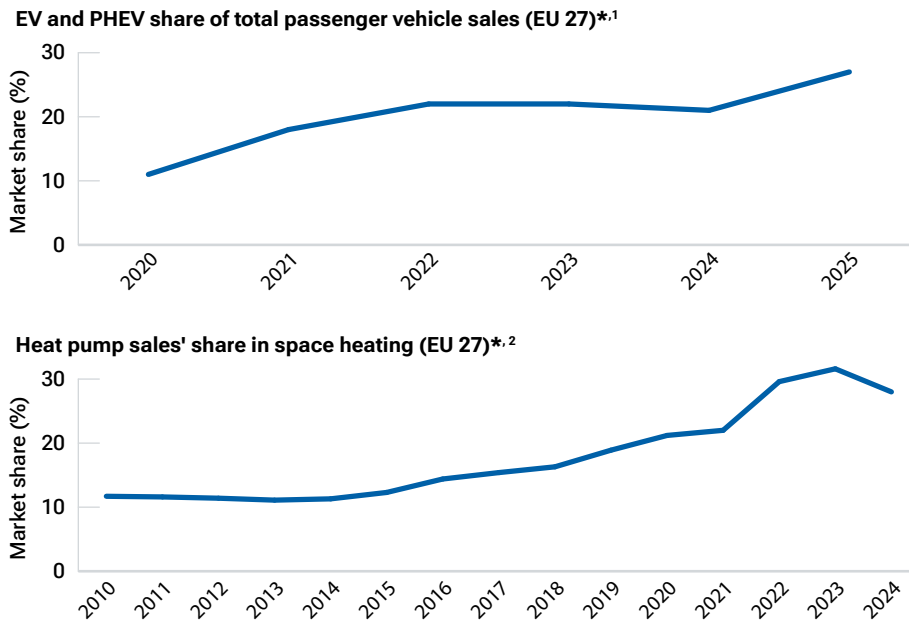
The adoption of the 2040 target passed by a wide margin, but the debate reflected increasing political contestation over the pace and cost of implementation—including fractures within Ursula von der Leyen's European People's Party that contributed to the inclusion of flexibility provisions. In our opinion, the addition of flexibility mechanisms could help make the policy more durable by helping to balance decarbonization goals with competitiveness and affordability—a good parallel could be the phased implementation of the EU Emissions Trading System (ETS1).¹

¹ The EU Emissions Trading System (EU ETS) is the EU's cap-and-trade carbon market. The cap refers to the limit set on the total amount of GHG that can be emitted by installations and operators covered under the scope of the system. This cap is reduced annually in line with the EU's climate target.

 **The most binding security-of-supply question is increasingly about electricity and whether the system can reliably meet rising demand from AI and data centers.**

In the EU, electric vehicle and heat pump market share has risen over time

(Fig. 3)



* EU 27 refers to the 27 member states of the European Union.

¹ Source: European Federation for Transport and Environment.

² Source: European Heat Pump Association.

A key tool for achieving the next wave of emissions reductions is the second EU Emissions Trading System (ETS2), which applies carbon pricing to road transport and buildings. ETS2 is designed to accelerate adoption of electric vehicles and heat pumps, but its rollout has become politically sensitive amid cost-of-living pressures and member-state concerns.

Europe has already made material progress on decarbonization since 1990, having already reduced absolute GHG emissions by 38% as of 2024.² This progress has been driven largely by energy efficiency improvements and a greener electricity mix. In fact, wind and solar electricity accounted for 30% of EU generation in 2025, which was higher than the contribution from fossil fuels (29%) for the first time.³

Similar pressures, different policy playbooks

A defining feature of the current environment is that the EU and U.S. are responding to similar energy-system pressures with different policy instruments. Both face a trilemma of sustainability, security, and affordability, but the relative weight of each objective differs, as do market structures and legal constraints. The EU is structurally exposed as a net importer of oil and gas, while the U.S. is a net exporter. Yet U.S. energy security concerns remain acute and increasingly centered on the ability to supply reliable electricity.

Looking ahead, policy may remain volatile, but the underlying economics of renewables and the politics of energy security are likely to keep the transition moving. A plausible near-term pathway is that the U.S. faces a chaotic transition in which some legacy fossil assets remain in operation longer than expected to maintain reliability, while investment accelerates in lower-cost renewables and enabling infrastructure.

² International Energy Agency (IEA).

³ European Electricity Review 2026 (January 22, 2026), Ember, ember-energy.org/app/uploads/2026/01/EMBER-Report-European-Electricity-Review-2026.pdf.

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