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on the European economy and industry facing the climate change challenge

Special Committee on the Financial, Economic and Social Crisis

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"*Today's financial crisis can be a gateway to tomorrow's environmentally responsible economy*"
Al Gore,
Former Vice-President of the United States

1. Introduction

The current economic crisis has had severe consequences. In particular it brought loss of jobs for millions of peoples and loss of confidence in the financial sector, which resulted in a plunge in loans to businesses and high number of bankruptcies.

According to the EU 2020 strategy[1], "strong dependence on fossil fuels... and inefficient use of raw materials expose our consumers and businesses to harmful and costly price shocks, threatening our economic security and contributing to climate change". In this context, the current crisis also presents an opportunity to make a crucial transition to a resource-efficient, low-carbon economy that is sustainable in the long run. This is supported by the expectation that the green technologies market will triple by 2030 and that up to 25 million new 'green' jobs could by created globally by 2050[2], provided the appropriate policy measures are taken.

2. The move to a sustainable economy

According to Deutsche Bank Climate Change Advisors[3], the shift in fuel supply will result in a broad success for the companies that are investing in clean energy technologies. Already, climate change sectors have outperformed the other market sectors since the markets hit rock bottom in March 2009. This holds especially for energy efficiency companies, whose returns have increased over 125%.

While investors would like to take advantage of this shift, they will also look for transparency, longevity and certainty in order to deploy capital. Consequently, stable climate and resource-use policies need to be in place to reduce the risks that accompany an uncertain and indecisive Europe.

European Emission Trading System (EU ETS)

Work has started on introducing these needed policies but it is incomplete. For example, under the EU ETS, CO_2 emissions from certain sectors like the power, steel and cement industry have been given a price. But EU ETS has so far not proven to provide a stable, transparent or certain framework to reduce fossil energy use.

As recently pointed out by the Environmental Audit Committee of the UK[4], emission caps under EU ETS were set too high and the carbon price has, therefore, been too low to encourage the necessary investment in low-carbon processes. A carbon price of €20-€40 per ton of CO_2 is expected in 2020, while the price needs to be around €100 to decarbonise the economy.

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1 Commission Communication of 3 March 2010, "Europe 2020: a strategy for smart, sustainable and inclusive growth", (COM (2010) 2020).
2 Statement of UK Prime Minister Gordon Brown.
3 "Investing in Climate Change 2010: A Strategic Asset Allocation Perspective", January 2010.
4 "The role of carbon markets in preventing dangerous climate change", January 2010.

A core problem of the current EU ETS is the "hangover" of surplus emissions permits from Phase II, which can be banked for use in Phase III. This would not only undermine the effectiveness of the system, but would also lead to companies starting Phase III in very different positions. Therefore, the EU ETS cap should be tightened, e.g. by limiting the access to Clean Development Mechanism (CDM) permits, adopting a higher ambition target and cancelling the "new entrant reserve"[1] allowances.

All allowances need to be auctioned, since free allocation reduces the incentives for companies to cut down emissions. Ideally, a legally binding climate agreement is reached in which all countries take effective action to reduce emissions. If all countries put a price on carbon, there will be no risk of carbon leakage. As this is currently not the case, under Phase III of EU ETS, many industrial sectors will be exempted from auctioning because they are "at risk of carbon leakage". Around 75% of the industrial sectors are eligible for free allocation, while a recent study[2] shows that complete auctioning of allowances would drive only less than 2% of emissions abroad.

Therefore, any measure to tackle carbon leakage should be limited and differentiated to the type of leakage (investment or operational[3]) and exposed sector. Free allocation as a main approach to tackle carbon leakage carries serious drawbacks. It places the burden on other sectors, since the carbon price faced by the rest of industry increases by up to 30%[4]. And at the same time, the sectors at stake can increase their profits by passing on the full carbon costs for credits they have received for free.

We propose to consider moving away from free allocation towards a combination of auctioning and some form of border levelling since it is more effective. The aim of EU border levelling is to ensure that producers from outside the EU face similar carbon costs, e.g. by requiring them to purchase CDM credits. With the CDM credits mitigation projects in developing countries are funded.

The introduction of a floor price on carbon in the form of an auction reserve price would help to reduce volatility of carbon prices and thus the risks of investing in low carbon projects. This idea is also supported by Joseph Stiglitz, who recently announced that the financial crisis has shown that it is dangerous to rely on carbon trading without such a floor price.

Energy efficiency

Energy efficiency is one of the most promising growth areas: it will not only reduce energy consumption and costs, but also improve our energy security, enhance the competitiveness of our companies and create other social benefits like lower greenhouse gas (GHG) emissions.

A study by McKinsey[5] shows that energy efficiency could reduce global GHG emissions by 30% per year relative to business-as-usual emissions in 2030, of which 50% with negative costs[6]. Unfortunately, several market imperfections reduce the uptake of these opportunities

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1 Member States are allowed to set aside a national pool of spare allowances for new or expanding industrial installations. Unused allocations from installations that are closed down are added to this pool.

2 Carbon Trust & Climate Strategies, "Tackling carbon leakage: Sector-specific solutions for a world of unequal carbon prices", March 2010.

3 Investment leakage involves relocation outside the EU, while operational leakage refers to reducing output in favour of imports.

4 Carbon Trust & Climate Strategies, *idem*. p. 2.

5 McKinsey & Company, "Pathways to a Low-Carbon Economy", 2009.

6 Energy savings outweigh the upfront investment costs.

with net economic benefit such as the malfunctioning of financial markets. In the current capital-constrained economy, investors might choose the low-capital opportunities instead of the most cost-effective ones that have high initial costs. An EU energy savings fund combined with a binding energy savings target could spur the adoption of energy efficiency measures.

A different tax regime

Billions have been spent and lost in this global financial crisis. In this difficult time it is imperative to increase employment and make labour more attractive. It is therefore necessary to shift away from taxing labour towards taxing environmental pollution and capital. A harmonised tax regime for vehicles based on CO_2 emissions was insisted on by the Commission and backed by Parliament. Carbon taxes for the non-ETS sectors (e.g. buildings, transport) will increase overall welfare and cost-efficiency according to the Commissions impact assessment[1].

In addition, a tax on financial transactions could reduce volatility and speculative trading in capital markets, limit socially undesirable transactions and help stabilizing financial markets. Together with an appropriate supervision framework, it could contribute to a more long term oriented financial system.

3. Vision of a future economy

The future and sustainable economy will need to move beyond economic growth, since GDP is no measure for well-being or sustainability. The focus on GDP has led to short-term profits, the depletion of natural resources and almost only benefited the richest 10% of our societies.

Shifting away from an economy driven by fossil fuels to a low-carbon one, presents vast possibilities for businesses and industry. Clear, certain and predictable climate change policies are needed to ensure that EU retains a place at the frontier of this shift. Provided the appropriate economic policies are put in place, a positive impact on employment is to be expected[2]. In the EU, up to seven times more green jobs could be created in the next ten years than would be lost in the coal and nuclear sectors[3]. This is because green sectors, such as buildings insulation or renewable energies, are more labour intensive than their substitute industries such as oil, gas and the nuclear industry.

The effects of the crisis on the car industry, for example, were the most profound; car production in Europe fell by more than 25% in the first half of 2009 compared to the same period the year before. Demand for passenger cars - especially large, fuel-consuming ones - have dropped to historically low levels. This industry, which is currently reliant on heavy industrial processes, will be affected by the rising shifts in oil prices and shifting demand for hybrid cars. It needs to fundamentally change as it will not be able to fall back on the pre-crisis business-as-usual scenario. Although the transition period is going to be difficult for workers in this sector, even with the necessary training programs, the alternative is to hold on to a sector of the past, running on finite and expensive fossil fuels from third-countries.

The importance of change also rings true for the steel sector - another industry, which cannot have a future without innovation. It needs iron ore and fossil fuels, which are finite resources.

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1 SEC(2008)0085, part. II, p. 51.

2 European Trade Union Confederation, "Climate Change and employment", February 2007.

3 European Renewable Energy Council and Greenpeace "Working for the climate: renewable energy & green job [r]evolution", August 2009.

Ensuring the competitiveness of that industry will depend on its ability to rely less on the highly unstable market for finite natural resources. High recycling rates and the use of renewable energy are indispensible, if EU were to retain its competitiveness in the steel sector.

Overall, the companies, which will come out of this crisis as winners are the ones that can reap the benefits from the shift in demand to green and durable products and services. Spikes in oil prices or shortages of certain raw materials will not hurt such companies, as they have found ways to reduce their dependencies on foreign imports for their inputs through efficiency and recycling.

At the same time, there will also be a large-scale redistribution of jobs, mostly within sectors. Jobs will be created in companies that can take advantage of the opportunities created by climate policies, while jobs will be lost in companies that cannot adapt. The occupational transitions should be anticipated and dealt with properly in order to reassure workers and enable them to adapt their skills to the structural changes.

To secure a successful and socially just transition on the labour market, the key focus of employment policies must be on life-long learning, access to education and training for all, and high levels of social and transition security between education and employment or between jobs. Neither in economic or social terms is it acceptable to leave people behind; therefore it must be ensured, that every employee is equipped to participate in the new green economy.

4. Efficient use of natural resources

The crisis has exposed fundamental weaknesses of our economy. Therefore, future economic growth can only be secured, if we transform our economy into a resource efficient one. Reducing dependence on non-renewable resources is more than just recovering from the "fossil fuel addiction"; it also entails lower use of raw materials like land, water, metals and other natural resources.

The share of raw material costs in total inputs for final demand is limited compared to labour costs, for example[1], and therefore, so are the incentives of companies to reduce the use of natural resources. Nevertheless, the growing world population and rising industrialization lead to intensified competition for raw materials. In the EU the supplies of natural resources like rare metals are sparse. Faced with resource shortages in the hands of politically unstable regions, the EU can only keep its competitive advantage by using natural resources more efficiently, for example through recycling and innovative, cradle-to-cradle product designs.

It is also necessary to ensure that the burden of future resource shortages and the associated higher prices for food and energy on the most vulnerable people is not disproportionally high. Energy poverty can to a certain extent be addressed by better insulation of homes and other energy efficiency measures. This, however, may not be enough. The future economy needs to be sustainable in the long run, not only for the environment, but on a social level as well.

A revised EU strategy is needed to guarantee accessibility to key natural resources for the EU industry. Such a strategy needs to tackle, in particular, resource efficiency and recycling, through higher, more inclusive and better defined recycling targets.

[1] CE Delft, "Resource productivity, competitiveness and environmental policies", December 2009.

5. Specific recommendations

a) Internalizing environmental effects by:

1) **Tightening the EU ETS cap, full auctioning, border levelling and an auction reserve price.**
   The EU needs to increase its emissions reduction target from 20% to at least 30%. Recent analysis has shown that continuation of the 20% target would imply an EU reduction of only 4% compared to business-as-usual[1]. Also, there is the risk that the EU ETS price would fall to near zero, due to the banking of surplus allowances from Phase II to Phase III and the possibility to have 50% of the reductions covered by the Clean Development Mechanism. Tightening the EU ETS cap by increasing the emission reduction target to 30%, full auctioning, border levelling and an auction reserve price could reduce this risk.
2) **Introducing a carbon tax for the non-ETS sectors, e.g. buildings and transport.**
3) **Introducing a tax on financial transactions.**
4) **Introducing a market-based instrument for biodiversity** (e.g. through a Green Development Mechanism[2]). Under such schemes, biodiversity would get a value by rewarding conservation measures and discouraging biodiversity destructing economic activities.
5) **Phasing out environmentally harmful subsidies to fossil fuel consumption/production, agriculture and transport.**

b) (Improved) Legislation on energy savings, soil, recycling and renewables by:

1) **Adopting a binding energy savings target of 20% in 2020.**
2) **Speeding up the adoption of a soil directive.**
3) **Improving recycling targets and definitions.**
4) **Introducing an emission performance standard for power plants.**
5) **Developing an interconnection plan for a European smart grid.**

c) Financing

1) **Introducing subsidies for the development of innovative and sustainable technologies and enabling businesses and individuals to access financing for energy saving measures.**
   In its resolution of 11 March 2010 on investing in the development of low carbon technologies (SET-Plan)[3], the Parliament has asked for at least €2 billion per year of the EU budget to be spent on developing low-carbon technologies.
2) **Prioritising climate change in the forthcoming budget reform**
   The budget should be restructured from unsustainable subsidies towards more future-oriented investments in education, R&D, renewable energy, sustainable agricultural

[1] CE Delft, "Why the EU could and should adopt higher greenhouse gas reduction targets", March 2010.
[2] Netherlands, Environmental Assessment Agency, "A Green Development Mechanism, Biodiversity compensation on a global, regional and biome scale", 2009.
[3] P7_TA-PROV(2010)0064.

practices, etc.

3) **Linking the EU Structural Funds with social and environmental conditions.**

A climate assessment should be introduced for all structural funds interventions, which should apply immediately to major projects. Higher levels of coherence between policies, investments and use of the specific funds should be secured. For example, the Globalisation Fund could be used much more efficiently in order to help workers upgrade their skills to enable them to find employment in the new, green sectors.

4) **Offering preferential rates to finance projects with a high social and environmental value through the European Investment Bank.**

The EIB could borrow funds on financial markets at preferential rates thanks to Member States guarantees and funding from the EU Budget. An EU agency could prioritise projects (for example energy efficiency investments, development of public transport, smart grids) that could benefit from such low interest rates, which would strengthen their profitability.

5) **The Commission should issue green bonds with Member States guarantees in order to finance green investments.**

d) Mainstream climate in other EU policies

Climate Commissioner Hedegård has made it her objective that every proposal by the Commission should meet the economic and environmental goals of the EU. It is essential that climate change is mainstreamed in other EU policies, in particular industrial, trade and employment policies. Therefore, climate impact assessment should be introduced for any directive proposed by the Commission.