AT A GLANCE

Requested by the ECON committee

Study in Focus

European Parliament

The Green Deal's growth, financial and regulatory challenges

A Roadmap for Reallocation

The original full study[1] critically assesses the proposed Green Deal's growth, financing and regulatory challenges. The study discusses the need for a strong narrative and coordination. It examines the key growth drivers of the Green Deal and the green investment gap, the optimal mix of taxation and command-and-control measures, trade and competition policy and the implications for macroprudential supervision.

Check out the original full study by scanning this QR code!

Background

The European Green Deal represents a total make-over of the European economy, with considerable impact on society at large, in a comprehensive effort to achieve a climate neutral Union by 2050. In the process, two so-called externalities must be addressed. There is the negative externality of human-induced climate change, saddling other people with the societal costs of our fossil fuel use for example. At the same time, innovation towards cleaner technologies brings positive spill-overs, generating 'free' opportunities for others to further build on and exploit an inventor's original idea.

The success of the far-reaching transformation hinges on the behavioural changes it can induce among consumers, workers, producers or investors to minimise the negative climate change externality while maximising the innovation externality. Putting a price on greenhouse gas emissions, whether explicitly through an emissions trading system or carbon taxes, or implicitly in the form of regulation, is necessary to have producers and consumers take into account the effect of their behaviour on others. But such price signalling may not be sufficient to spur innovation and productivity. Neither will temperature-rise or carbon-budget milestones placed at convenient decadal intervals by themselves generate society-wide support for the Green Deal.

The main challenge to the framework for achieving climate-neutrality is how to coordinate and harness individual member states', producers' or investors' efforts in a Union-wide pathway that embodies the common but differentiated responsibilities of the United Nations Framework Convention on Climate Change.

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Key findings

- The Green Deal would benefit from a comprehensive and shared narrative in which individual climate actions can be situated in time, where trade-offs between the various social, environmental and economic objectives can be transparently made, and through which awareness and public support can be raised. The four key growth drivers of the Green Deal are to a large extent interrelated and must be actively managed accordingly.

- The 'green investment gap' can be bridged, taking into account the displacement of fossil fuel subsidies, and the net benefits (to health care for example) of a more sustainable environment; The annual additional investment need of EUR 250-300 billion is comparable to the amount of fossil fuel subsidies in the European Union and to the net benefits of a more sustainable environment, in particular the health care savings as a result of decreased pollution of air, land and water.

- To finance the Green Deal, the key challenge is matching supply with demand. If the absolute size of the green investment gap is surmountable and demand is high, it is the appropriate supply of eligible investment vehicles that must be the objective of the European Sustainable Investment Plan. Environmental taxation must be accompanied with 'revenue recycling' to enhance acceptability.

- The 'Brussels Effect', the Union de facto exporting its elevated environmental standards, should not be underestimated. The explicit alternative, a Border Carbon Adjustment, merits a careful impact assessment from an environmental, economic, social and political point of view.

- The timing of climate change introduces a specific risk to macro- and financial stability. Too slow climate action gives rise to physical risk; too fast may lead to stranded assets. Central banks, in particular, will need to make clear to what extent they are actively involved – for example, promoting 'green' bonds – or rather act as a passive watchful observer and regulator.

[1] https://www.europarl.europa.eu/RegData/etudes/STUD/2020/648785/IPOL_STU(2020)648785_EN.pdf

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