

European Recovery post-COVID19 and the Green Deal

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Introduction

The COVID-19 crisis has not only brought social and economic life to a standstill but has also posed a fresh challenge to the relevance of the European Union (EU), in particular regarding its capability to deal with such a crisis. EU member states have since grappled with individual coping measures and exit strategies. A coordinated European response has been weak if not missing. Launched in December 2019, the EU's green deal, an estimated multi-trillion euros initiative, set up to ensure a sustainable transition to carbon neutrality by 2050, has also been put under question.

However, any attempt at overcoming the negative impact of months-long stagnation of the economy, as well as a possible economic crisis touted to be bigger than the 2008 financial crisis, will require strong coordinated action led by the EU. Such action must put the European Green Deal centre stage of the bloc's approach to long-term recovery and strategic autonomy. The green deal can also be a channel to revitalise the dwindling manufacturing sector in Europe, which as the crisis has revealed, is highly strategic to European interests.

Immediate Emergency Actions

The immediate response to COVID-19 has been dominated by quick responses of individual EU member states, often implemented in a non-coordinated

- As the focus shifts from emergency towards recovery, an EU-wide approach will be needed more than ever.
- The economic constraints associated to Covid-19 constitute both a challenge and an opportunity for the European Green Deal ambitions, depending on the design of emergency and recovery policies.
- Post crisis, ensuring viable value and supply chains of basic materials industries will be critical.

manner given the perception that individual EU member states would be best placed to respond to an overwhelmingly health-related crisis. Preference for national measures has therefore initially impeded the EU as a whole to agree on a common roadmap for immediate action. However, as the focus shifts from emergency actions towards recovery, an EU-wide approach is needed more than ever as uncoordinated actions by individual member states would fail to have the impact needed.

The design of such recovery packages has been amply debated, in particular, the link between recovery packages and the agenda of the European Commission with regard to the Green Deal. Several EU leaders have been of the opinion that the current situation being a health emergency, recovery should focus on citizens'

health.ⁱ The Polish deputy minister for state assets, Kowalski, suggested the EU Emissions Trading Scheme (ETS) should be removed from 2021 onwards and countries be allowed to take care of climate action on their own. The Czech prime minister Babiš called for scrapping the Green Deal and focusing efforts on the Coronavirus. The first vice-president of the Romanian ruling party likewise asked all Romanian MEPs to support the abandonment of the Green Deal. These concerns were eventually placated by the European Commission as the latter updated state aid rules applicable to firms receiving government support to not oblige them on greening initiatives for aid received.

Nevertheless, support for the Green Deal as part of the economic recovery of the Union has grown. Representatives of the governments of 17 member states (mostly Ministers of Environment) signed a letter stipulating their support for transforming the EU into a sustainable and carbon-neutral economy as part of economic recovery. This came at the time when the European Commission President indicated that the strengthened European budget would have to be concentrated on a few areas, namely: increased financial support for investment and reforms in Member States and cohesion; modern policies: the European Green Deal, digital transition and increased strategic autonomy; the EU's common crisis response; and strengthening the support to the EU's neighbourhood and partners.

The final recovery package proposed by the European Commission on 27 May eventually incorporated links to the Green Deal, mostly based on the 'do no harm' principle, meaning that recovery projects should definitely not lead to an increase in emissions. More specifically, 25% of the proposed EUR 750 billion recovery fund are to be earmarked for climate action and applied throughout the EU's updated budget proposal and recovery programmes. The instrument will consist of both grants and loans.

Funding will be sought on financial markets and distributed to industries and countries hardest hit by the upcoming economic downturn. Several member states, such as Austria, Denmark, the Netherlands and Sweden have already stated that they would agree with neither a mutualization of debt nor an increase in the EU budget. However, the proposal, called 'Next Generation EU', will need the approval of all member states in order to pass. This is indeed just the beginning of a long negotiation and must be met with cautious optimism.

The Covid-19 challenges and opportunities for the European Green Deal

The Von der Leyen Commission has made it clear that climate is among its top political priorities. Reaching climate neutrality by 2050 is the core objective of the European Green Deal presented at the end of 2019, with details on the Deal's implementation expected later this year. However, there is now growing debate on the possible impact of the Covid-19 crisis on EU climate ambitions. Such an impact is likely to be mixed as for the EU's emissions, economics and climate politics.

Emission dynamics and carbon pricing. Given the impact of the outbreak on economic activity, greenhouse gas (GHG) emissions are likely to go down in the short term, especially when it comes to transport and – to a lesser extent – power generation. While confinement measures are reducing transport emissions, the merit order effect is benefitting the share of renewable energy in the current demand-constrained power landscape. Yet, a temporary relief will be of little significance for the overall attainment of targets, since emissions are expected to bounce back as the economy picks up, possibly under the impulse of recovery packages. When an economic downturn occurred in the wake of the financial crisis of 2008-2010, emission allowance prices fell due to a

lack of supply adjustment, to the benefit of coal. New EU legislation has been introduced in the meantime to reduce demand/supply imbalances in emission allowances across economic cycles, so that the Covid-19 crisis may provide a test case to assess the effectiveness of the EU's new instruments for its climate plans. Additional factors of turbulence on carbon markets may stem from the consolidation of low oil prices, as a combination of storage saturation and contraction of demand is likely to be protracted. However, it should be also considered that periods of low oil prices are usually politically inviting for the introduction of command-and-control carbon pricing instruments i.e. carbon taxation or price floors.

Funding. Crisis and post-crisis periods are usually not conducive to the mobilisation of additional public finance for environmental investment, despite the usual expansion of public finance to stimulate the economy. In response to the crisis of 2008-2010, the EU recovery package (EPRR – European Economic Recovery Programme) dedicated a very small portion of available finance to climate and energy, resulting in a missed opportunity with respect to the climate transition. This tendency seems to be confirmed by emergency bailouts, that the EU has left under member states' responsibility by allowing state aid and invoking an escape clause of the Stability and Growth Pact. Many of these national packages avoided attaching green conditionalities, i.e. in emergency support to the hard-hit civil aviation sector. However, the recovery package presented by the European Commission seems to challenge such a "tradition", stating the intention to make extraordinary recovery finance instrumental to attain the goals of the European Green Deal. In particular, the Commission intends to focus the part of the package expected to support the Green Deal on building renovation, renewable energy deployment – including hydrogen -, electromobility, and coping with the distributional consequences of the transition in coal regions through a boost of the Just Transition Fund.

Design and governance are key. Design-wise, given the extraordinary, one-off nature of the package, it could make sense to concentrate resources towards the expansion of large-scale, labour-intensive interventions such as building renovation or green procurement in the mobility sectors. More regular streams of EU funding – possibly reinforced by an expansion of own resources by way of carbon border adjustment or ETS revenues – would be more appropriate to support capital-intensive measures that need continuity. These include research and innovation in low carbon technologies – especially for the hard-to-abate sectors – and infrastructural upgrades, i.e. those required to develop hydrogen-based clusters for industrial decarbonization. To this extent, especially the EU budget design should better integrate the climate neutrality principle by boosting the funding of Horizon Europe and the Connecting Europe Facility, which should be, however, prevented from supporting fossil fuel infrastructures not in line with the Paris Agreement. Governance-wise, the envisaged disbursement – which will need approval by the Commission – should be linked to the National Energy and Climate Plans (NECPs) introduced by the Governance of the Energy Union Regulation adopted in 2018. The budget could be a powerful instrument to reward the climate ambition and/or performance of NECPs. Alignment of expenditure to the NECPs could ensure a more straightforward connection between the recovery finance and the 2030/2050 climate objectives.

Climate politics. The design of EU recovery package(s) and the post-Covid-19 patterns of the European Green Deal will be largely shaped by the extent to which political commitment to decarbonization will falter (or not) to the benefit of other objectives. An element to consider is the extent to which the epidemic may intensify a battle of interests and narratives already affecting the EU and its member states around the renewed climate ambitions. As member states discuss the

Commission's EU Climate Law proposal, contentious elements include the increase of the 2030 emissions reduction target from 40% to 50-55%, or the Commission's intention of recurring to delegated legislation to revise targets. Besides this, there is heated intra-EU debate on the possible introduction of a border carbon adjustment tax. So far, calls to de-prioritise the European Green Deal have been mounting among several Central and Eastern European member states - where a "climate versus growth" frame prevails - and national-conservative and far-right parties across Europe, which are particularly prone to culturally polarize the climate discourse. However, should these tensions not reach the (unlikely) point of scrapping the European Green Deal, elements of compromise may be found through the prioritization of the industrial and social dimensions of the Green Deal – as elements that seem to enjoy a broader support. The package approach to recovery – and the sheer complexity of its design – could be expected to satisfy the asks of many countries and coalitions.

European energy intensive industry: Stimulate and regulate

Energy intensive or basic materials industries, such as steel, cement, chemicals, glass and non-ferrous production, link to every possible economic sector, including each other, forming an intricate system of value chains. With the COVID-19 crisis, industries along with economies have come to a halt, international trade routes have been disrupted or closed, major disruptions in value chains (raw materials, supply and demand) have ensued, markets have contracted, and delays and costs increased. As essential supplies in particular ran low, exacerbated only by the shift of manufacturing to China over decades, it has become starkly clear how important basic materials industries are to national and indeed EU interests.

As such, the strategic value of the basic materials industry in Europe became clearly visible during the Corona health crisis. These industries and their value chains are essential in the provision of critical medicines and medical and protective equipment. However, in the face of shortages brought on by the Covid-19 pandemic, a number of European industrial sectors have modified or changed production lines to supply such equipment (e.g. diagnostic tests, ventilators, protective masks, gloves and gowns, Intensive Care Unit medicines and equipment, and protective clothing) to patients and healthcare workers across Europe. For instance, chemical company INEOS, drew up plans to produce 1 million bottles of hand sanitizing gel per month to cover the European shortage.ⁱⁱ INEOS is not alone. There have been numerous other such examples.

Shortly prior to the outset of the Covid-19 outbreak and subsequent lockdown measures in EU member states, the European Commission had released along with its signature initiative, the European Green Deal, a new industrial strategy for basic materials industries. The industrial strategy is intended to help shepherd industry to achieve the target of carbon neutrality set by the Green Deal. Although there have been many industrial strategies released in the past, this one for the first time aims at carbon neutrality by 2050. While the industrial strategy has been widely supported by the basic materials industry sectors - some of whom have already published their own mid-century climate neutrality roadmaps - it has fallen short on details and ignored some of the classic industrial value chains which, as seen during the Covid-19 crisis, have proved highly strategic to European interests.

The EU's Green Deal is a unique opportunity for industry to transition to a carbon neutral Europe while safeguarding competitiveness. The Green Deal can indeed provide the much-needed stimulus for infrastructure, electrification of industrial processes, more renewable energy in the energy mix,

adequate supply of hydrogen, CO₂ capture, greater advancement of circular economy to strengthen local value chains as well as the creation of robust new value chains. Over the course of the last three decades, industry has largely picked the low-hanging fruits of energy efficiency and a number of production plants in the EU are close to the thermodynamic limits of current processes. New, innovative low-carbon technologies will be required for industry to now achieve carbon neutrality. In this regard, the Green Deal will be crucial to help secure the necessary finance required for breakthrough low-carbon technologies to overcome innovation valleys of death and reach demonstration and commercialisation.

Recovery from the Covid-19 pandemic can come about from a renewed commitment to carbon neutrality by 2050. In the immediate term, European industry will require stimulus, but such stimulus packages are likely to come without strong green strings attached. However, recovery packages (that go beyond immediate emergency) must require EU countries to adhere to climate and environmental commitments when supporting ailing companies. Support can also come in the form of regulation and standards to create new markets for low-CO₂ products and the circular economy. While the EU has indeed expressed interest in exploring border carbon adjustment taxes, it is unlikely they can be set up swiftly and without international dispute or retaliatory measures. With or without border carbon adjustment taxes, it is certain that Europe will not import carbon-intensive products while producing low-carbon itself. Therefore, it is recommended to look into other policy instruments that can stimulate and protect domestic climate friendly production. In this regard, the greening of the EU internal market via low-CO₂ standards on final products and green public procurement could have a bigger impact. Standards set at EU level often reverberate outside of EU borders given that non-EU producers will have to apply these too to keep market access to the EU internal market. However, such standards must

be controlled and enforced rigorously also and in particular for imports.

Other measures will also be needed through collective action by the EU and Member States to maintain open and efficient trade supply chains, both within the EU and with the EU's trading partners. Fast lanes for basic materials could help in this regard. Ensuring viable value and supply chains will be critical especially given the uncertainty over how long the crisis will last and the possibility of further disruption. The Chinese economy has notably already bounced back from the crisis: in April, China's exports grew by 3.5 per cent and imports fell by 14.2 per cent while in India, the Modi government has recently begun developing land twice the size of Luxembourg to facilitate businesses and boost manufacturing in India as a result of Covid-19 supply disruption.

In the short and long term, the goal of a carbon neutral Europe by 2050 is clear. Industry will be vital for achieving this target given that every conceivable low-carbon technology, ranging from energy-efficient buildings, decarbonised transport (hybrid, electric and fuel cell vehicles) renewable energy (solar PVs, wind turbines, thermal systems, etc.), battery storage, and so on relies on materials from the energy intensive industries. The EU's Green Deal provides the most clear-cut pathway to ensure industry remains in Europe while achieving carbon neutral growth.

Conclusions

As the EU is slowly moving past the health emergency situation caused by Covid-19, the main priority has become to revive economic life. Currently it remains unclear what the severity of the expected crisis will be or whether it will portend a return to austerity. Whereas short-term emergency actions have been taken at both the national and the European level, the Commission needs to be in the driving seat for

a more coordinated pan-European recovery. For a sustainable recovery, it would be essential that the EU pursues its Green Deal agenda more swiftly.

Recovery funding should focus on those interventions likely to create more jobs in the short run and providing quick and tangible impact on emissions, while more stable and long-term lines of funding should focus on paving the way for the decarbonisation of the hard-to-abate sectors. Governance will be essential, and opportunities arise for linking the Multi Annual Financial Framework's

(MFF) instruments to National Energy and Climate Plans (NCEP) for guidance and conditionality. Concentrating resources on the social and industrial aspects of the transition will be also of paramount importance to steer through political resistance across the member states. For greater strategic autonomy, it will be essential to strengthen industrial value and supply chains. The EU's Green Deal can be a unique opportunity for industry to transition to a carbon neutral Europe while safeguarding competitiveness.

References

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