

The European Green Deal after Corona: Implications for EU climate policy

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Abstract

Climate change policy cannot be the first priority of the EU for the immediate future. However, in spite of the corona-crisis the urgency of climate change mitigation has not disappeared. The post-corona recovery can both put the EU's decarbonisation progress back on track – after low-carbon investments will inevitably take a hit – but the EU's Green Deal proposals can likewise support the general economic recovery. It will be important to ensure that recovery measures are compatible with global climate change and European Green Deal priorities so that stimulus money will flow to economic activities that have a place in a climate-neutral world. As time passes, the re-launch may actually offer a unique opportunity for the EU to live up to the Green Deal's promise of economic modernisation along the Paris decarbonisation objectives. The period we have until the relaunch should be used to develop a new agenda. These ideas will not per se be off-the-shelf but go beyond current solutions for decarbonisation. Instead of tinkering around the margins, the EU should focus on transformational technologies, and for example go big on low-carbon infrastructure, efficient buildings, and lead markets to boost demand for climate-neutral industry.



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The coronavirus (SARS-CoV-2) crisis is first and foremost a public health crisis. Policymakers should focus on resolving it with the greatest possible urgency. However, when the European economies finally enter the phase of recovery, the urgency of mitigating climate change will not have dissipated. There is a risk that neglect of climate action during the recovery will deal a heavy blow to efforts to ‘bend the curve’ of greenhouse gas emissions in line with the goals of the Paris Agreement.

Already today, some member states have called for climate measures to be scrapped. The Polish deputy minister for state assets Kowalski suggested¹ the EU ETS should be discontinued from next year onwards while the Czech prime minister Babiš called for scrapping the Green Deal. The first vice-president of the Romanian ruling party likewise asked all Romanian MEPs to support the abandonment of the Green Deal and the diversion of funds for supporting national economies and health systems. Those calls – and similar suggestions to scrap existing climate policies and strategies wholesale – are misplaced: climate change will neither disappear nor be resolved because of the coronavirus.

Climate policy may no longer be the first priority of the EU, but to re-embark on a high-carbon future development pathway should not be seen as a viable economic strategy for exiting the crisis. However, it is also too early to draw conclusions on the actual economic implications. Therefore, it may be wise to postpone new decisions, such as an increase in the emissions reductions target for 2030 to 50-55%. Far-reaching decisions are best taken once the full implications of the crisis are known, not least because impact assessments are challenging when uncertainty is high. Some upping of the 2030 target – if politically and economically feasible – would certainly be helpful. The twenty years that remain between 2030 and 2050 to reach climate-neutrality (as firmly endorsed by the European Council) will be very challenging from a decarbonisation perspective as it will involve the hard-to-abate sectors. Nevertheless, an increase in the 2030 target would mean a proportionately less steep emissions reduction pathway beyond 2030.

The European Commission rightly rebutted² the notion that the public health crisis should lead to the EU Climate Law proposal being scrapped. The proposed Climate Law, which would embed the EU’s climate-neutrality target for 2050 into EU legislation, is aimed precisely at shielding the “generational challenge of climate change” from more pressing and immediate priorities. Indeed, the Climate Law has the potential to strengthen EU climate policy governance, which is likely to be indispensable for reaching EU climate objectives. However, in the context of the current crisis, the European Commission may face difficulties in obtaining its desired powers to amend climate trajectories by delegated acts as envisaged in the Climate Law. The suggestions by Poland, Czechia and Romania to slow down climate ambitions may point towards the potential challenges the Commission could face in managing energy and

¹ <https://www.euractiv.com/section/emissions-trading-scheme/news/eu-should-scrap-emissions-trading-scheme-polish-official-says/>

² See e.g. <https://euobserver.com/coronavirus/147815>

climate policy through National Energy and Climate Plans in the absence of binding national targets.

Short-term implications

In the short-term, emissions will decline, likely significantly. As a comparison, in 2009 in the midst of the financial crisis, total EU GHG emissions decreased by 376 MTCO₂e. Based on the duration of restrictions imposed by governments and the magnitude of the consequent economic contraction, there may be a greater effect in 2020 than in 2009: total EU GHG emissions³ might decrease by between 250 and 450 mega-tonnes of CO₂e⁴ compared to 2019. ENTSO-E data already reveals a decline in electricity consumption in most EU countries, especially in those most affected by the coronavirus outbreak, such as Italy and Spain. Based on the merit order of electricity markets, this will result, to a significant extent, in lower levels of electricity generation from fossil fuels, especially lignite and hard coal.

Recent data released by the National Bureau of Statistics of China⁵ for the months of January and February also give an indication of the scale of the coronavirus impact on economic activity, with industrial production having shrunk by 13.5%. The transport sector will be among the hardest hit by the efforts to limit the spread of the virus, with personal transport and aviation showing the most significant slowdowns. Moreover, a mild winter has already caused a reduction in energy demand in January and February compared to 2019 and a consequent decline in emissions.

This effect, however, will likely be short-lived. EU ETS emissions⁶ declined by nearly 10% between 2008 and 2009, before rebounding by 2013. After the Eurozone crisis of 2015, emissions have been declining gradually while economic growth recovered, driven by electricity sector abatement (see figure 1).

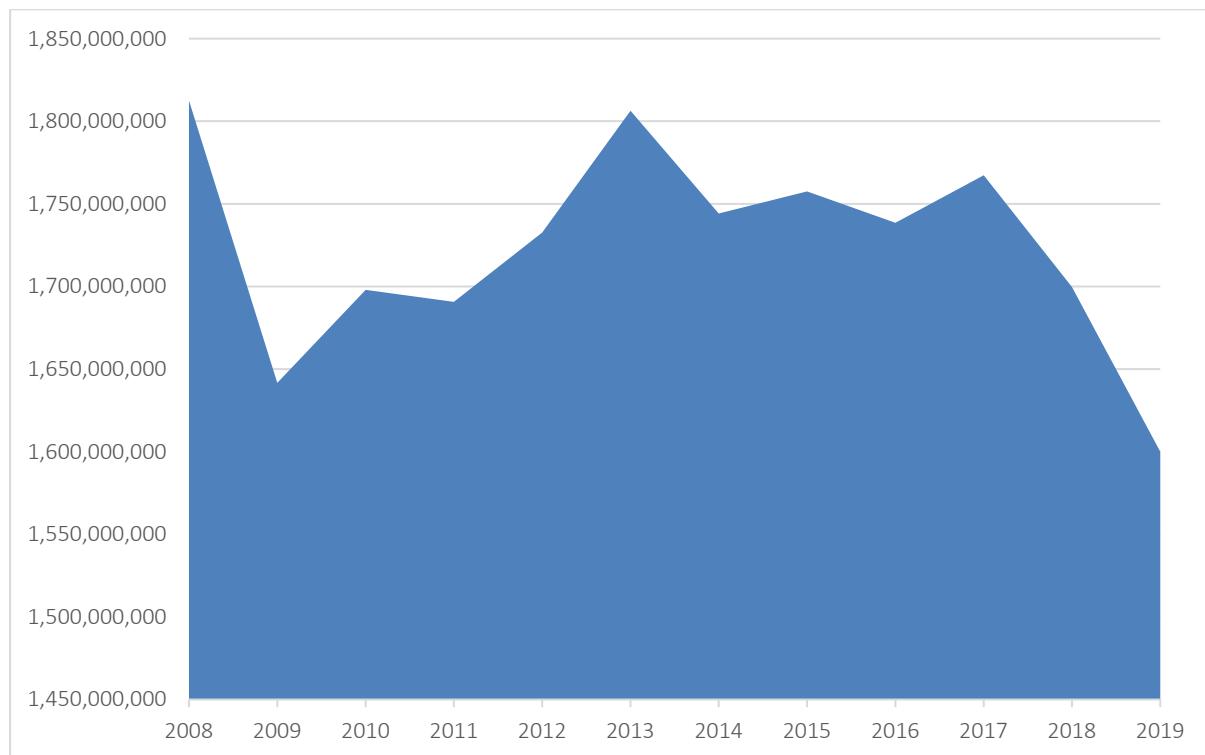
Since the onset of the corona crisis, the price of allowances has dropped by over a third from around €25 to €16, reflecting the fall in financial markets in general. In contrast to other carbon pricing methods, such as a carbon tax, the ETS as a cap-and-trade system is anticyclical. As economic activity and allowance demand go down, so does the ETS price, thereby preventing the ETS becoming an additional burden to carbon-intensive sectors.

³ EU27 + UK.

⁴ The estimations are based on the decrease of electricity production reported by ENTSO-E, the recent set of statistics released by the [Chinese Government](#) on economic activity in January and February, as well as some assumptions made for a similar calculation conducted for Germany by Agora Energiewende ([2020](#)). The estimations vary according to the assumptions made about the duration and extent of restrictions imposed by EU governments.

⁵ http://www.stats.gov.cn/tjsj/zxfb/202003/t20200316_1732233.html

⁶ ETS emissions for 2019 (to be confirmed in April 2020) are expected to be around 1.6 billion tonnes.

Figure 1. EU ETS emissions 2008-2019⁷

Source: EU Transaction Log.

The intuition in ‘normal’ times would be to be concerned about lower carbon prices. With emissions declining, and many companies under stress from the economic shock, lower carbon prices should not be a short-term concern. Some companies may sell allowances to raise cash in the short term. The Market Stability Reserve will reduce future auction volumes if the allowance surplus increases in the short term. Moreover, if the surplus increases, the number of allowances that will be invalidated from 2023 onwards will likewise increase.⁸ In the recovery phase, the planned review of the Market Stability Reserve or proposals such as a carbon price floor can be revisited to ensure that the carbon price signal is strengthened when output levels increase again.

When this happens, guiding economic output towards lower-carbon activities will be key. In the 2008 financial crisis, energy efficiency and emissions reductions were not a main priority in the recovery phase. For example, the €200 billion European Economic Recovery Programme reserved only 2% for climate and energy spending.⁹ Together with depressed private investment, older and more inefficient production facilities may run for longer. Both will be negative for emissions *trends*.

⁷ Value for 2019 is based on an estimate. Please note truncated y-axis.

⁸ For more detail on how the Market Stability Reserve leads to automatic invalidation of surplus allowances, see: <https://www.ceps.eu/ceps-publications/strong-revision-eu-ets-future-may-bring-impetus-further-reform/>

⁹ https://ec.europa.eu/economy_finance/articles/eu_economic_situation/article13502_en.htm

There is a risk that coal bail-out measures will ‘artificially’ extend the operation of already uneconomic coal, which for example is the case in Romania. This will crowd out renewable or less carbon-intensive sources such as natural gas, delaying the transition and make it more expensive in the future. Lower ETS prices are most likely to affect coal generation, both during the slowdown and recovery.

Should restrictive measures last for a long period, e.g. months, it could become more difficult to operate the EU ETS. For example, the extensive system of monitoring, reporting and verification of emissions includes site visits by regulatory authorities and other enlisted service providers. Just as for some businesses, certain member states are considering deferring tax payments, the compliance dates for the ETS could and in such extreme circumstances most likely will be extended.¹⁰

In a recession, there might still be pressure to relieve industry from carbon costs, beyond the anti-cyclical effect of the ETS. There may be calls for reverting to free allocation of allowances, instead of auctioning. However, as we have learned from the past, this would generate windfall profits in the power sector, which would pass on the market value of allowances to customers, as it did from 2005 to 2012 when it received its emissions certificates for free. This occurs because companies could always sell the freely allocated allowances on the market instead of using them for compliance. When the cost of allowances is passed through, consumers (who may be worried about electricity bills) or electro-intensive industries still face carbon costs. Energy-intensive industry already receives a large majority of allowances for free, in addition to reduced or exempted grid fees, renewable levies and compensation for indirect carbon costs related to electricity price increases.

With new ETS rules coming into effect in 2021, the free allocation volumes to industrial installations will also be updated more quickly if there are changes in production levels. This should help prevent supply-demand imbalances in the EU ETS to accumulate to the same extent as happened in the aftermath of the 2008 crisis.

The aviation sector, which is being hit very hard, will experience reduced demand for EU allowances, further contributing to lower ETS prices. Outside of the EU ETS, transport sector emissions will be down as a result of personal transport being curtailed and lower economic activity. Energy-use in buildings may increase in the residential sector but decrease elsewhere. This may make it easier for member states to reach emissions reduction targets under the Effort Sharing framework.

Meeting targets easily might not make the case for renewables and energy efficiency. 2020 is a target year for both member states and the EU as a whole. For renewables in particular, sustained lockdowns and the liquidity and capital constraints this brings may slow down deployment. Limited capacity for local governments may add to this. While potentially missing

¹⁰ A first indication of this is a statement by the German emissions trading authority: https://www.dehst.de/SharedDocs/mailing/EN/2020/2020-03-20_corona.html

targets may not be a significant political problem in light of the crisis, it may nevertheless have legal implications as the European Commission is required to enforce EU Directives.

The agricultural sector is mainly supported through the common agricultural policy, which can play a major role both in greening agriculture as well as in supporting the sector throughout the crisis. Its strategic importance for food security is elevated for as long as global borders are fragmented, although EU coordination should ensure that cargo and trade in goods continues without disruption.

Finance

Public and private finances alike will be under stress, but the former should find fewer constraints. The stability and growth pact's escape clause¹¹ for exceptional circumstances has been activated and will not be a constraint on any fiscal expenditure. The key finance element for climate change will be the low-carbon conditionality of public support.

Size of the budget

EU GDP will nevertheless take a hit. This will have knock-on effects for any funding that is based on shares of GDP. If the member states impose ceilings as a percentage of GDP, the financial size of the EU budget will have to be revised to account for the downturn, curtailing the budget. Revisions of EU budget ceilings based on inflation and growth are a normal practice, often not questioned when GDP grows beyond initial estimations, but controversial in a recession.

In addition, the contributions to the EU budget suffer from a statistical time lag. A reduction in contributions only takes effect in practice one to two years later than the contraction, as final GDP estimations are released, meaning that lower contributions are not aligned to the period of impact on national treasuries. With the negotiations ongoing for the next Multiannual Financial Framework, the polarisation of the opinions will increase, with SARS-CoV-2 impact being used as a strong argument to reduce the budget by some member states (mainly net contributors), and conversely as a proof that more common action and finance is needed by other member states (mainly net beneficiaries).

If the EU budget is curtailed, it can have adverse consequences for climate-related investment and innovation funding. With some countries very reticent about reducing pre-allocated agricultural and cohesion support, cuts would disproportionately fall in the non-reallocated lines, such as the Connecting Europe Facility, research and innovation programmes (e.g. Horizon Europe) or security and defence, exactly those areas where real EU value added is created and where common action is essential.

Funding generated by monetising ETS allowances could also decline if the ETS price does not recover. E.g. the ETS Innovation Fund which will be formed by selling 450 million allowances is

¹¹ This escape clause was formally activated on [23 March 2020](#).

worth over €3 billion less at today's carbon prices compared with the estimated value at the beginning of the year.

Potential asymmetries and regional impacts

As the economic impacts and responses may turn asymmetric between member states and regions, the impact on funding instruments based on relative GDP per capita (e.g. Cohesion Funds) may become out of step with new economic realities. For example, the eligibility for the Modernisation Fund,¹² moreover, is based on relative GDP per capita in 2013. Due to the economic shock, some member states may have become (in)eligible if the calculations were updated for 2020. This may create political pressure to update eligibility criteria, which in return might open up many more discussions. This happened with Greece: due to the impact of the 2015 Eurozone crisis, its relative GDP dropped below 60% of the EU average after the initial rules of the Modernisation Fund had been proposed. This was later addressed in the ETS legislation.

State aid could be practically unlimited for the foreseeable future. The EU Treaties explicitly allows state aid to make good damages in "exceptional occurrences".¹³ The other justification clauses to remedy serious economic disturbances and to facilitate the development of certain economic activities also apply, as outlined in a State Aid Communication on the crisis.¹⁴ Notification of state aid is still required. Member states should be able to respond to the immediate health crisis without constraints imposed by the state aid framework. In the recovery phase, however, the notification and approval process could be pivotal in guiding member state investment towards lower-carbon infrastructure and production.

The social and industrial dimensions of the Green Deal will be elevated in importance. In the short-term, protecting incomes should be prioritised. In the recovery phase, member states should consider what jobs in carbon-intensive economic activities are precarious and whether the focus should be on jobs as such or on the sectors in which they are located. The industrial strategy of the EU, released while the virus outbreak accelerated, would have to remain coherent with the Green Deal. This will be even more true post-crisis due to the large-scale fiscal policy interventions foreseen. Likewise, initiatives such as the 'coal regions in transition' can play an important role as conduits for the recovery and to ensure that this recovery will be 'future-proof'.

¹² <https://www.ceps.eu/ceps-publications/the-opportunities-of-the-modernisation-fund-for-the-energy-transition-in-central-and-eastern-europe/>

¹³ Art 107(2b) TFEU.

¹⁴ https://ec.europa.eu/competition/state_aid/what_is_new/sa_covid19_temporary-framework.pdf

The longer term

For the less immediate future, it will be important to ensure that the economic recovery and stimulus measures are compatible with EU and global climate change and Green Deal priorities. For example, any bailouts, subsidies, or other forms of sustained fiscal support to carbon-intensive economic activities should be checked against possibilities to invest in climate-neutral production, processes and operation. Contrary to how it is sometimes presented, the Green Deal is not there to impose extra restrictions on carbon-intensive activities, but instead meant to be a pillar of the EU economic growth and modernisation strategy, as for example been outlined in the November 2018 European Commission Long-Term Strategy.¹⁵

Climate-neutral energy infrastructure is one area where investment could particularly make a difference. Electricity grids need to deal with higher shares of renewables in the future, carbon capture and storage infrastructure allows energy-intensive industries to reduce hard-to-abate emissions, and hydrogen should be transported from where it can be produced in a carbon-neutral way to where it can help sectors decarbonise.

Likewise, the Green Deal's focus on renovating buildings and addressing energy-use requires massive investment and policy attention of national and local authorities. There is an opportunity to focus on the carbon content of infrastructures or in buildings, e.g. steel, cement, copper, aluminium and other materials, the value chain of which is responsible for 50% of global greenhouse gas emissions.¹⁶ The introduction of carbon content rules in post-crisis recovery measures can provide an opportunity for governments to restore long-term climate objectives in economic activity. Lead markets for climate-neutral products to bring down costs can play an important role here.¹⁷ This can include green public procurement,¹⁸ carbon contracts for differences¹⁹ or industrial public-private partnerships.

The reason for including climate and decarbonisation during the recovery is not to opportunistically jump on board any fiscal stimulus that may be available. As the crisis will invariably make some investments more difficult, securing Green Deal priorities in the recovery programmes will be essential to ensure that the EU's climate action will not be undermined after the crisis.

While it may be understandable that all options, including a radical break with existing policies, are on the table during an unprecedented crisis, the corona crisis represents an exogenous

¹⁵ European Commission (2018) – Communication: A Clean Planet For All.

¹⁶ OECD (2018), "Global Material Resources Outlook to 2060 - Economic drivers and environmental consequences".

¹⁷ <https://www.ceps.eu/ceps-publications/tools-boost-investment-low-carbon-technologies/>

¹⁸ See the forthcoming paper by CEPS on Green Public Procurement.

¹⁹ https://www.iddri.org/sites/default/files/PDF/Publications/Catalogue%20Iddri/Etude/201910-ST0619-CfDs_0.pdf

symmetric shock²⁰ to the whole EU and its neighbouring countries (even if demographics and response measures may create asymmetries later). The most critical economic and fiscal policy interventions will be to provide liquidity, protect incomes and to keep businesses afloat. Carbon costs, or other regulations more generally, are and will not be a driver of this crisis.

Policymakers may face a choice in whether the emphasis of the EU policy response will be on carbon pricing through the ETS, or on more demand-side industrial policy measures such as lead markets. When fiscal resources are scarce, the former may seem more attractive.²¹ On the other hand, the political economy of strengthening carbon pricing may become more challenging. Carbon pricing concentrates the costs of climate policy in a small number of industries (potentially with balance sheets under pressure) while diffusing the environmental benefits. Demand-side measures, conversely, concentrate the benefits at first (e.g. subsidies to bring down technology costs) while diffusing the fiscal costs.²²

The crisis will also provide an involuntary natural experiment in ‘degrowth’ as a climate strategy. Emissions will go down, potentially significantly, but significantly more tonnes of CO₂ will continue to be emitted in spite of large-scale economic output reduction and disruption across society. Rather, the transformation towards climate-neutrality requires ‘degrowth’ only in carbon-intensive activities, and rapid growth and scaling-up of more climate-neutral alternatives. Once the pandemic passes, the temporary impacts may quickly be overcompensated by the need to ‘recover’ lost time and to introduce incentives to spur demand to save suppliers in distress.

Longer term, the link between temperature increases and pandemics and infectious disease demands more research attention (and funding). The IPCC in its special report on the 1.5° C target states with “high confidence” that the transmission of infectious disease is affected by higher temperatures, but the effect can be in either direction depending on the disease. Future research should particularly target the risks of increased transmission diseases with high infectiousness, and therefore systemic risk.²³

Implications beyond the EU borders

One of the implications may be that COP26 to be held in Glasgow in November 2020 may need to be postponed or at least adapted. Such a decision is up to the countries represented at the UNFCCC. Irrespective of the public health perspective, preparatory meetings at the UNFCCC may be or have been cancelled, leading to delays of various negotiation tracks. COP26 has been

²⁰ See also the Letter of Eurogroup President Centeno of 24 March 2020, which talks about a symmetric shock <https://www.consilium.europa.eu/en/press/press-releases/2020/03/25/letter-of-eurogroup-president-mario-centeno-to-the-president-of-the-european-council-following-the-eurogroup-of-24-march-2020/>

²¹ <https://www.ceps.eu/financing-europes-green-deal-beware-of-the-waterbed-effect/>

²² This political economy argument is further discussed in Elkerbout, M. (2020). The Changing Role of Carbon Pricing in the EU. National Institute Economic Review No 251, Feb 2020. It builds on the work of Emil Dimanchev at MIT.

²³ See A Pandemic Foretold” <https://www.ceps.eu/ceps-publications/chronicle-of-a-pandemic-foretold/>

meant to lead to a global upgrade in climate commitments, requiring high-level political commitment. However, in the context of the pandemic, governments may not have the bandwidth to engage with international climate policy at a sufficiently senior level. Moreover, some actions agreed in the Paris Agreement should be implemented by the end of 2020 and do not depend on the COP26 as such. This includes updating nationally determined contributions (which remain a wholly domestic sovereign decision) and international climate finance commitments.

With regard to Brexit, the transition period might need to be extended. No European economy should risk the potential increased disruption after 31 December 2020 that might ensue if there is no new EU-UK trade agreement in place. Nor is there enough time to negotiate specific joint climate institutions, such as linked emissions trading systems.

The economic situation is further complicated by the falling oil prices, with Brent trading below \$25 per barrel for the first time since the early 2000s. This was caused by the combined impact of a price war between Russia and Saudi Arabia following a breakdown in OPEC+²⁴ negotiations and the decreased demand caused as a result of the coronavirus pandemic. Normally, such a situation would have a negative effect on low-carbon investments and on the appetite for investments for increasing energy efficiency. On the other hand, the *relative* returns on investment for low-carbon investments may increase, irrespective of who finances the investment. Nonetheless, unlike previous plunges in the price of oil, such as in 2014, the situation may play out differently. Decarbonised solutions are now more readily available at lower costs in the EU, long-term plans of automakers are unlikely to be changed according to these lower fuel costs given the requirements of existing EU legislation, and more ambitious EU and global targets provide certainty for investors about the commitment to decarbonisation (and can continue to do so even during economically uncertain times). Nonetheless, low oil prices may also extend the usage of existing assets, such as internal combustion vehicles, therefore depressing the replacement rate. Meanwhile, persistent low oil prices will likely undermine the pursuit of any meaningful climate agenda in countries whose budgets are dominated by oil revenues.

Outlook

Franklin Delano Roosevelt's New Deal was created in response to a then unprecedented economic crisis in the US. The current crisis is not driven by climate change, but the European Green Deal could nevertheless support the recovery. Moreover, if the recovery is implemented properly, the economic recovery has the potential to assist the low-carbon transition. The crisis may actually offer a unique opportunity for the EU to live up to the Green Deal's promise of economic modernisation along the Paris decarbonisation objectives, allowing for a rethink of

²⁴ OPEC+ is an informal group of 24 oil-exporting countries. Its membership consists of the 14 members of the Organization of Petroleum Producing Countries (OPEC) and 10 other countries, including most notably Russia. Together, these countries represent roughly half of the global oil production and try to coordinate the quantity of oil they supply in order to influence prices.

national taxation, innovation, infrastructure, entrepreneurship or the reform of the common agricultural policy.

At this stage, it is too early to discuss the exact steps to make this happen. The important point however is to make low-carbon content in energy and materials both in the short and long-term a guiding principle for the recovery. We should also not forget that for the recovery to happen will require addressing the generally weak balance sheets of companies, that will be one outcome of the crisis. This is a major deterrent to private investments.

The current crisis may hold a lesson for climate change. Climate change is like a pandemic in slow motion; once our systems are ‘overwhelmed’, the impacts are likely to be unprecedented. The ‘recovery’ will also be in slow motion, because equivalents to containment (mitigation)²⁵ and building of intensive care units (adaptation) will have to operate over decades to bring greenhouse gases to levels more suitable for achieving the aim of a more stable socio-economic and environmental status. In both cases, the flow and its growth rate need to be tackled urgently so that concentrations do not lead to tipping points and other severe societal impacts. Finally, the pandemic shows that acting early prevents far greater costs down the line.

Key points:

- Even if GHG emissions will decline in the short term, the Corona crisis risks having a negative impact on EU and global emissions trends unless climate neutrality is an explicit criterion of the economic recovery programmes. Climate change will not disappear after the crisis.
- The crisis will require the EU to think big. This provides an opportunity to go beyond the incrementalism that has characterised climate policy to date. Possible areas for transformational approaches are the creation of low-carbon lead markets (as for example outlined in the European Commission’s New Industrial Strategy for Europe), the kick-start of the hydrogen economy or a focus on the basic material value chain, which is responsible for half of global GHG emissions.
- At the same time, the EU will need to remind itself on the value of carbon pricing and the EU ETS. In a period where there will be a lot of competition for fiscal resources, carbon pricing may become ever more important; it will be crucial to guide the recovery in a climate-friendly way while giving appropriate long-term price signals.

²⁵ The language of the pandemic response and climate change policy sometimes show similarities. See also this CEPs Policy Contribution “A Pandemic Foretold” <https://www.ceps.eu/ceps-publications/chronicle-of-a-pandemic-foretold/>



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