



## EEAC Working Group on Energy and Climate Change

The Hague, June 2020

**Subject:** Session outcome letter: How Covid19 will influence European energy and climate policies

Dear colleagues,

Through this session outcome letter I share the main lines of the online policy briefing that Milan Elkerbout (CEPS) provided to the energy and climate experts of the EEAC Network on May 19, 2020. In this briefing, the question on how the Covid19 crisis will influence European energy and climate policies was center staged.

### Introduction

In general, pre-corona EU climate policy was driven by the European Green Deal and the climate-neutrality Long-Term Strategy for 2050. These two main drivers are part of an ecosystem of policy frameworks and strategies that together shape the EU energy and climate policies. Important elements of this ecosystem include the EU's Industrial Strategy, sustainable finance policies and the Circular Economy Action Plan. In addition, fiscal policies, state aid, monetary policies and the recently proposed EU recovery funds will all play their part in shaping the dynamics of EU energy and climate policies.

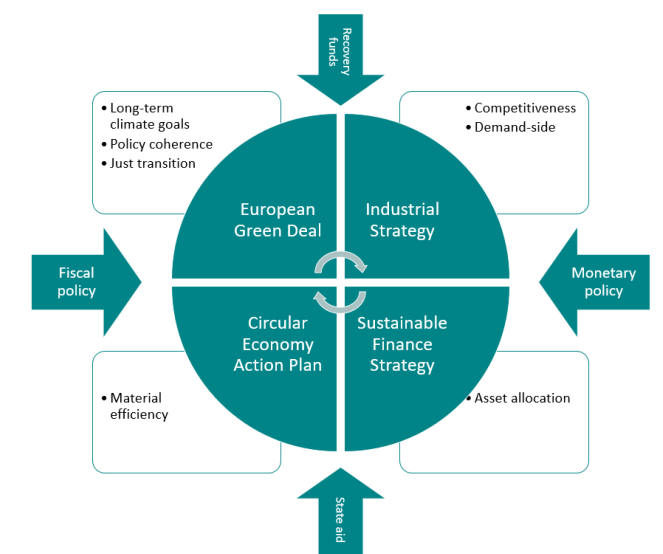


Figure 1: Dynamics of the EU energy and climate policy system. Source: Milan Elkerbout, CEPS



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### [The short term implications of the Covid19 crisis on EU energy and climate policies](#)

The impact of the Covid19 crisis on EU energy and climate policies, adjacent policy domains and related policy instruments surfaced rather immediate. The following implications were discussed during the briefing:

#### ***Emission reductions***

Often when an economic downturn appears, energy use and GHG-emissions are expected to go down, reflecting the declined economic output in the European area. During the current crisis, total EU GHG-emissions might decrease by between 250 and 450 mega-tonnes of CO<sub>2</sub> vis-à-vis 2019. Such decrease would be even larger than the reduction during the first year of the previous economic crisis that started in 2008.

#### ***Carbon prices***

With economic decline and emission reduction in the past few months, carbon prices also went down. However, carbon prices demonstrated a quite unexpected but modest rebound already in a few weeks after the first price drop. This rebound is a novelty, as such rebound was not seen during previous crises, such as the financial and fiscal crisis of 2008 to 2015. This rebound effect of carbon prices could indicate that the carbon market is more resilient than anticipated. The decline of carbon prices is logical and desirable from an economic perspective. For the climate however it could have negative effects, because lower carbon prices might redirect investments in more carbon intensive activities.

#### ***Political responses***

Besides the drop in emission, and the following market response, several politicians seized the opportunity to put pressure on the EU's energy and climate change agendas. GHG-emission reduction targets were to be frozen and all means should be redirected towards battling the Covid19 crisis and its expected aftermath, several EU member states argued in March and early April. Although neither the European Commission, nor the Council seems to be aiming to do so, it raises the question what would happen if for example GHG-emission reduction targets would be ramped up for 2030, while lacking political consensus.

#### ***A more difficult target year***

Regardless of Covid19, 2020 is a target year for EU energy and climate change policies, including ETS/transport, energy efficiency and renewable energy. Whereas energy efficiency targets may be obtained easier with lower energy consumption, meeting renewable targets might be more complex although shares of renewables will be higher when energy consumption declines. First of all, liquidity



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and capital constraints may have negative implications for the deployment of renewable energy sources. Secondly, limited capacity for local governments may add to this.

### ***Resilient policies***

For the moment it seems that the overarching policy initiative for EU energy and climate change policies, The European Green Deal, is sufficiently resilient to face the challenges posed by the Covid19 crisis. Although the Green Deal was not designed to counter a crisis, the Deal proposals can support the general economic recovery.

Also other energy and climate change policies seem to be well enough equipped to deal with the current challenges. For example, the European Trading Scheme's market stability mechanism seems to function well as a shock absorber on the shorter term, although its need to be seen what happens if the crisis sustains. Also the EU's Effort Sharing Mechanism seems to sustain, although higher ambitions may not receive unanimous support in all Member States and by all political fractions in Parliament. Similarly, other important policy domains – such as the industrial strategy of the EU – should be well monitored in the context of the Covid19 crisis and its effects on EU energy and climate change policies.

### ***The longer-term, rebound effects & recovery***

Beyond the immediate consequences, also the longer-term effects were discussed during the policy briefing. The following issues were brought to the table:

### ***A sufficient focus***

GHG-emissions normally rebound with increased economic activity. So the temporary decline of emissions are just part of the short-term consequences. During the previous financial and fiscal crisis the EU did not pay major attention to subjects such as energy and climate change policies. This time around, 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. The rationale behind this is relatively simple: if recovery isn't green, long-term decarbonization suffers, potentially endangering the block's ambition to reach net zero by 2050.

### ***Preferred policy options***

Policy initiatives that are on the longer term favorable to the aims of the EU's energy and climate change targets and that currently require investment were discussed. For example, climate neutral energy infrastructure. Such infrastructure is one area where investment could make a difference. In that context, the lagging progress of the connection of the Iberian peninsula with the rest of the EU was mentioned as a matter of concern. Furthermore, the balance between pricing policies (carbon pricing through the ETS) or demand side industrial policies (e.g. lead markets) was discussed. Elkerbout



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argues in his recent publication that when fiscal resources are scarce, pricing policies may trump demand side industrial policies. However, this can become challenging, Elkerbout argues, “since carbon pricing concentrates the costs in a small number of industries while diffusing the environmental benefits. On the contrary, demand side measures concentrate the benefits at first while diffusing the fiscal costs<sup>1</sup>”.

### ***A just transition and the role of hydrogen***

In the context of the longer-term impacts of the Covid19 crisis on energy and climate change policies, the role of a just transition was included in the debate. There was general consensus that broadening the just transition approach – from exclusive focusing on coal regions towards a broader and more inclusive scope – would be both necessary and favorable. It should not necessarily mean that the energy transition in Europe would be negatively affected by this, several participating colleagues argued. Also, the role of hydrogen in the (green) recovery plans of the EU was discussed. The priority given by the European Commission could be well explained, Elkerbout stated. Hydrogen is a diverse instrument, but the downsides (e.g., emissions) should not be overlooked.

### **Finance, investment & taxation**

The Covid19 crisis will have major impact on the availability of both public and private funds. Also the asymmetric impact of the crisis and its aftermath will challenge Member States, but also the EU as a whole. In this paragraph, I summarize the issues discussed with regard to finance, investment and taxation.

### ***An optimal overlap***

Faced by the challenges of recovery after the Covid19 crisis, an optimal overlap of both public and private investments that serve (long term) energy and climate targets while simultaneously supporting positive economic impact is required. Such theoretical optimum is however often not in line with the preferred time frame politicians aim for in their attempt to reduce economic downturn and job loss. Politicians sometimes have a so-called shovel ready bias. The need for an approach that may not serve the optimum theoretic overlap, but that at least should be compatible with the EU's net zero ambition by 2050 was discussed and generally supported by the participating colleagues. In addition, it was noted that for example subsidies for consumers may be useful as a first step. However, such subsidies should not be too incremental in character to ensure that choices made sufficiently influence energy use levels.

Furthermore, public and private finances will be under stress. Private balance sheets will be in trouble, and although public finance might find fewer constraints - due to measures such as the stability and

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<sup>1</sup> Elkerbout et al. (2020). *The European Green Deal after Corona: Implications for EU climate policy*, CEPS, Brussels



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growth pact's escape clause – funding will decline, e.g. through a smaller EU budget, and smaller ETS funds. Nevertheless, Elkerbout identified the low-carbon conditionality of public support as the key finance element for climate change.

### ***An asymmetric impact***

Concerns were raised about the a-symmetric impact of the crisis and its aftermath across Europe. Not only the impact of the virus is a-symmetric, also the expected economic consequences will be a-symmetric. This is especially concerning since the countries that are hit the hardest by Covid19 were only recovering from the financial and fiscal crisis and the austerity measures that followed. In addition, concerns were raised that the risk of divergence between 'north and south', would be even further supported though a-symmetric abilities to provide state aid.

In this context a just and green transition was mentioned as a preferred way out of the crisis. Such approach should focus on jobs and skills but should also include investments in energy infrastructure and lead low carbon markets. Investments could for example be made to ensure that renewable energy can flood better through the grid, and that hydrogen technology is allowed to better pick up speed. All in all, the EU needs to invest in infrastructure, lead-markets, transformational investments, and all with the conditionality that such investments prepare for an economy that is ready for climate neutrality.

### ***Look into alternatives as well***

We also discussed the potential role of GHG-emission taxation mechanisms, such as the proposed carbon border adjustment mechanism. Although there is quite some push for such mechanism by politicians and industries alike, it is tremendously complicated in bureaucratic terms. Including for example the question of legality of it all under WTO rules. Although the European Commission is expected to go ahead with looking into options for the introduction of such mechanism, Elkerbout underlined that Europe also should look into alternatives, such as consumption charges or product standards.

### **Global & macroeconomic picture**

The EU does not operate in splendid isolation. In this final part of the outcome letter some of the global and macroeconomic elements of this crisis in the context of energy and climate change policies are included.

### **COP26**

The postponed COP26 was briefly discussed. The reasons to postpone (available political bandwidth, travel and social limitations, etc) were touched upon and duly noted. It was mentioned that a



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postponed COP should however not lead to reduced attention for and commitment to the climate change challenges.

### ***Dropping prices a problem?***

Furthermore, the role of a volatile oil market was discussed. The steep decline of prices finds its origin in A) the price conflict between Russia and Saudi Arabia and of course B) decreased demand caused by the consequences of the Covid19 crisis. Although low oil prices could extend the usage of existing assets and might undermine the pursuit of meaningful decarbonization action my oil depended states, the negative effect on low-carbon investments could be less as in previous cases when oil prices dropped. Firstly, Decarbonized solutions are now more readily available at lower costs in the EU. Secondly, existing EU legislation still makes it relatively unattractive to change course for companies to lean again towards carbon related investments Thirdly, ambitious EU and global targets provide certainty for investors about the commitment to decarbonization, whereas oil markets remain rather volatile.

### ***No cause for celebration***

Although low oil prices may not directly have a negative effect on low carbon investments<sup>2</sup> and policies, and GHG-emissions are at a low, these matters are no reason for celebration. First of all, the emission drop is linked to economic decline and will therefore be temporary and will make little difference to the world's ability to meet the goals of the Paris agreement. Some participating colleagues added that there is an even more worrying signal. Although emissions went down, the actual GHG concentration in the atmosphere only reduced with a very limited amount. This sobering messages demonstrates once again what drastic change is required if the world is serious about meeting the Paris targets.

### **To Conclude**

The policy briefing by Milan Elkerbout and the contributions made by the participating colleagues, provided an interesting overview of and insights in the possible effects of the Covid19 crisis on European energy and climate policies. Through this letter I would like to once again thank Milan Elkerbout and all colleagues for their contribution.

Sincerely yours,

Folmer de Haan,

Chairman EEAC Working Group on Energy and Climate Change

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<sup>2</sup> Low oil prices could even have a positive impact, in that the returns on oil investments become less attractive