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How to secure support for the Green Deal? A plea for prioritization

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Defining European policies to support industrial investments is now officially on the European Council's agenda, following Enrico Letta's recent report on the strengthening of the common market. Different Member States and actors have different visions of these policies. Tim Elias Peter, from the Konrad Adenauer Foundation, affiliated with but independent from the German Christian Democratic party, discusses what these policies should and should not be. "The European Green Deal is increasingly running into rough waters. The debate is less critical of the large, long-term framework for achieving climate neutrality than of small-scale, short-term measures. And the reason for the troubled waters is by no means a failure to meet targets: the Green Deal delivers." This blog post delves into what it considers the centrepiece of European climate policy: the EU emissions trading system, and its contribution to the ambitious climate objective and the cohesion and direction needed to progress on it.

The European Green Deal is increasingly running into rough waters. It is the flagship project of the von der Leyen Commission and is intended to ensure that the EU becomes climate-neutral by 2050. The reason for the troubled waters is by no means a failure to meet targets: the Green Deal delivers. With the Fit for 55 climate protection program, the EU will reduce greenhouse gas emissions by at least 55% by 2030 compared to 1990 levels. The European Emissions Trading System (ETS), the centrepiece of European climate policy, will make the main contribution to this. It is used to price CO2 emissions through certificate trading. Emissions trading is therefore a market-based climate protection instrument that will achieve its goal as efficiently as possible. By extending

emissions trading to buildings, transport, and other sectors (ETS 2), this instrument will also achieve emissions reductions across sectors in future.

Criticism from key players in society

On the way to this goal, however, the EU is at risk of losing the support of large parts of society. These are not people who either do not take climate change seriously, question Europe's contribution to solving this global problem or do not believe in man-made climate change at all. Instead, critical voices are increasingly coming from the key players in society: entrepreneurs, skilled workers, craftsmen–in other words, those who are supposed to implement the Green Deal in practice. In the German debate, criticism of European measures is being mixed with criticism of initiatives by the German government. The national Heating Act is mentioned in one sentence with the Due Diligence Directive and the Nature Restoration Law. These three examples alone show that the core concern of climate protection is being combined with environmental and social issues, and attempts are being made to achieve all goals at the same time, asking too much of society and economy.

It is worth noting that the debate is less critical of the large, long-term framework for achieving climate neutrality, i.e. European emissions trading in particular, than of small-scale, short-term measures. From an entrepreneurial perspective, it is a smaller challenge if the CO2 price rises reliably over several years as a result of emissions trading–companies can adjust to this and make the necessary investments. In comparison, it becomes problematic if, for example, the REACH regulation means that a certain chemical that is essential for current production is no longer approved with a short lead time. Investments worth millions can be written off so quickly and would never have been made in the first place if the company had known about the future ban. This uncertainty, here exemplified by chemicals, is what wears down society's top performers. And it costs support for the actual, major goal of climate neutrality.

The EU’s initiatives to boost competitiveness

The EU is taking steps in the right direction with the Green Deal Industrial Plan, the New European Competitiveness Deal and the reports by Enrico Letta on the internal market and Mario Draghi on long-term competitiveness. But the same principle applies here: measures that create a long-term framework and benefit the European economy as a whole are preferable to ad hoc measures for individual companies or sectors. A deepening of the European single market, in particular a capital markets union, will have a positive effect across the board. Within this framework, the most competitive companies can emerge and prosper. In a market economy, on the other hand, subsidies to individual companies or sectors are always the exception and must be plausibly justified. Using tax money from the economy as a whole to support individual companies generally weakens the economy as a whole. For example, the relaxation of state aid rules in response to the US Inflation Reduction Act (IRA) leads to major distortions of competition in the European single market. Financially strong countries such as Germany and France can invest billions in subsidies in factories for chips and batteries, while financially weaker Italy is left behind. Italian companies that are actually competitive are not awarded the contract. This is a prime example of how the competitiveness of the entire EU is weakened by individual distortions of competition.

The EU between the USA and China

But how should we react to massive state subsidies in the form of the IRA or Chinese state capitalism? This question certainly cannot be answered adequately in a short blog post, but it can perhaps be described using an example. There is also a heated debate in Germany as to whether the European solar industry should be protected from the

dumping of Chinese manufacturers or the incentives of the IRA. The migration of solar manufacturer Meyer Burger from Germany to the USA illustrates the current situation. Several arguments are being mixed up in the debate, ranging from strengthening one's own competitiveness to reducing dependency on China. Both objectives can complement each other but must be kept separate in their approach and choice of instruments.

In terms of competitiveness, the production of solar panels does not currently promise high margins. Rather, the European economy as a whole benefits from the fact that it is supported by cheap Chinese suppliers. To put it in a nutshell: Chinese taxpayers are subsidizing the European energy transition. Due to the current shortage of skilled workers, a broad subsidization of the industry would lead to a so-called crowding-out effect. Well-trained personnel would have to be poached from other competitive industries in order to build up the solar sector. The situation is different if research and development in the clean tech sector is financially supported. Europe's competitiveness does not lie in low-cost mass products, but in high-quality R&D-intensive products. For example, next-generation solar panels or a completely different product could be developed in the field of hydrogen. Whether it is then cheaper to have this product produced inside or outside Europe is not decisive. The decisive factor is the competitive advantage that a better product with effective patent protection has.

In the area of resilience, the reasoning is different. If more solar module manufacturers were to migrate, import dependency on China could rise to almost 100%. Would this be considered critical, interventions would be needed. The fact that solar panels are a different commodity compared to oil or gas is an argument against classifying them as critical. They are not "burned up” but provide electricity even if new supplies fail to materialize. In addition, other suppliers on the global market, for example from the USA, could step in. The commodity is therefore not comparable with the pharmaceutical sector, where there are really critical dependencies in the area of antibiotics, for example. However, if an almost complete dependence on imports for solar panels is considered too risky, individual support measures could maintain a small production base in Europe that could be scaled up in an emergency context. One option here is public tenders with a quota for goods produced in Europe, similar to, but more effective than, the Net Zero Industry Act. However, this approach can be justified solely on the basis of the resilience argument and not on the grounds of competitiveness. Rather, more expensive public tenders would result in welfare losses.

Back to the market-based roots

Although the European solar industry and the clean tech sector are important for the climate transformation, they are a small sector compared to the economy as a whole. In order to bring the economy and society along on the path to climate transformation, there has to be prioritization in the Green Deal. Emissions trading should be positioned as the core instrument and not be sidelined by other instruments. For example, the de facto ban on combustion engines from 2035 does not reflect the technology openness of emissions trading. Such measures lead to massive losses in support for the Green Deal. If one takes the view that emissions trading is not sufficient in the building and transport sector due to the scheduling of the transformation, support measures should rather be taken, such as the expansion of the charging station infrastructure and the electricity grid as well as a reduction in electricity tax. If driving with electricity becomes cheaper than with gasoline, which is priced via emissions trading, people will be willing to switch.

In order to implement the guiding principle “climate protection must be worthwhile,” one crucial instrument is still missing: climate money. This is actually the twin instrument of emissions trading. A price is paid on CO2 via emissions trading, which then flows back to consumers via a per capita flat rate. Those who live in a climate-friendly way have more money in their pockets, those who don't do not. This core instrument also gives everyone their freedom. The sports car enthusiast can continue to drive his combustion sports car (then possibly with e-fuels) because he will renovate his house solely out of economic incentive and will probably not fly overseas on vacation. The twin instrument of climate money has not yet been introduced in Germany, for example, which damages the

legitimacy of emissions trading. An effective tightening of pollution certificates in the coming years is inconceivable without a legitimizing climate money. Otherwise, the impression is created that CO2 pricing is just another tax. Without climate money, even in Germany, rising CO2 prices could lead to Yellow Vest protests in the coming years.

The financial trilemma

How should the climate transformation be financed? This topic can also only be outlined in a blog post, which is why I would like to highlight a few guidelines. First of all, the instrument of emissions trading already points in the direction of decentralized, market-based solutions. The climate transformation must be financed for the most part by the private sector. The state must create the right incentive structure for this and create the framework for the necessary liquidity by deepening the European single market, in particular by creating a real capital markets union. The state itself can take action in the area of infrastructure. Additional incentives in the area of buildings and transport can also be discussed on a case-by-case basis.

However, this does not say where the billions for state investment should come from. Government measures to combat climate change serve to safeguard the right to freedom of future generations. In fact, a similar principle applies to government debt: high government debt restricts the freedom of future generations. For the financing of climate protection measures, this means that extensive debt should not be the first, but the last option. The conflicting situations can be summarized as follows: the younger generation is facing the immense challenge of climate transformation in their working lives. At the same time, as a result of demographic change, they have to care for more and more older citizens and may want to start a family themselves and buy their own house or apartment. In addition, the time of the peace dividend is over and higher military spending, also to compensate for investments not made in the past, must also be shouldered by the younger generation. In a nutshell, the younger generation finds itself in a trilemma of decarbonization, demography and defense. In the interest of intergenerational justice, the existing budget must therefore first prioritize away from consumer spending and towards investments before talking about new debt because new debt would then also have to be borne by the younger generation over the course of their working lives.

Conclusion

In summary, emissions trading is the EU's most important and effective instrument for achieving its climate targets. Emissions trading is the decisive efficiency difference in the EU's climate policy compared to China and the USA. However, the EU must not undermine support for the Green Deal with additional regulations. Conflicting goals between climate protection, environmental protection, social issues, and resilience must be recognized and prioritized accordingly. Unfortunately, the EU cannot achieve all goals at once without losing the support of large parts of the population. A focus on emissions trading with long-term, market-based framework conditions and a compensation mechanism in the form of climate money, on the other hand, gives companies and society planning security and ensures support for this project of the century.

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