

Policy Packages for European “Green Growth”

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1. The Challenge of Driving Growth in a Time of Austerity

Europe’s slow growth comes from the impact of low investment worsened by rising energy imports. GDP growth is being depressed by a slump in both business and public investment. Public investment is limited by budget constraints. Many large private companies hold record amounts of cash but a lack of confidence means they are also failing to invest.

If unaddressed the investment crisis will worsen in the coming years as banks consolidate their balance sheets and new financial regulations are implemented. Project financing for infrastructure in particular will become scarcer. This investment squeeze will further depress growth – especially in countries most hit by the crisis – and failure to modernise European infrastructure will hurt medium to long term EU productivity and competitiveness.

2. The Case for Low Carbon, High Efficiency Recovery

Of the many options available to stimulate growth driving investment into low carbon and high efficiency infrastructure has the strongest economic and political case.

To be economically efficient and practically effective interventions to stimulate additional investment must deliver three outcomes:

- **Increase sustainable demand:** private sector investment will only respond to a sustainable increase in effective demand. With effectively negative interest rates and public budget constraints it is difficult to do this through policies to increase private sector consumption. The alternative is to use policy to drive private investment which is repaid over time through increased user fees in energy, water waste and other sectors. European renewable energy policies have been effective at maintaining investment through the crisis, with over 60% of new electric power investment in 2011 being in renewable technologies. Policy incentives will also need to be supplemented by temporary public financial instruments in order to overcome shortfalls in bank lending due to perceptions of risk due to market immaturity and balance sheet consolidation.
- **Deliver supply-side efficiency:** to sustain growth in the medium to long term it is vital that policies to increase investment improve macro-economic efficiency, thus raising

¹ E3G is an independent non-profit organisation with the mission of accelerating the transition to sustainable development. All figures cited are from European Commission publications or can be found at www.roadmap2050.org, <http://www.e3g.org/programmes/climate-articles/press-release-energy-efficiency-offers-a-way-out-of-europes-economic-woes/> and <http://www.e3g.org/programmes/europe-articles/financing-the-decarbonisation-of-european-infrastructure/>

long-term productivity and resilience. Well understood market and policy failures mean that Europe has systematically under-invested in energy efficiency, energy grid infrastructure and alternative energy sources. Policies in these areas will remove market barriers, lower barriers to new entrants, increase competition and create incentives for wide-scale innovation.

Cost-effective energy efficiency programmes alone will reduce fossil fuel import costs by over €20 billion per annum to 2020. Additional EU infrastructure can save 10-15% of immediate costs, strengthen internal market competition and increase energy security. These investments will also improve macroeconomic resilience. Shifting to a low carbon investment path would save Europe over €300 billion in GDP losses from a moderate two year oil price spike in 2020.

- **Competitiveness and Public Benefits:** an additional priority for investment must be areas which improve EU competitiveness and deliver public good benefits. Global clean energy and environmental markets are growing very fast, with the Chinese market demand alone matching EU demand by 2015. For example, liberalisation of EU retail electricity markets facilitated by investment in smart grids will save money in Europe, and would also strengthen the competitiveness of EU companies to gain a larger share of the estimated €460 billion the Chinese will invest in smart grids over the next decade.

The EU currently has a strong share of global clean energy markets and some estimates show that stronger EU domestic action could raise clean energy exports by €250 billion to 2020. In the absence of action the EU's lead will erode as China, Korea, Mexico, Brazil and South Africa are all targeting clean energy markets as driver of exports and company growth. China is targeting clean energy, clean vehicles and environmental industries as its key areas of growth in the next decade, and will invest €11.5 billion in the clean vehicles sector alone.

Finally, investment in clean energy brings substantial long term climate security and health benefits to EU citizens, as well as delivering large employment benefits across all countries. As such it would provide a visible signal of European recovery which is seen to be responding to public concerns and needs.

Low carbon, high efficiency investment has the advantage of efficiently addressing both current depressed demand and driving medium to long term productivity. Perhaps as importantly, compared to other options it would gain strong public support due to its emphasis on strong public benefits, wide-spread employment and immediate gains to private, public and individual consumers in terms of reduced energy bills.

3. Five Policy Packages for “Green Growth”

The full benefits of “green growth” can only be delivered through coordinated action inside governments and across the EU. The current lack of joined up policy is one of the main reasons why these economically attractive options are not being developed.

For example, many Member States have objected to the draft provisions of the EU Energy Efficiency Directive (EED) which mandate a higher rate of economy-wide efficiency investment and specifically refurbishment of public buildings (schools, hospitals etc). No country denies that these are cost-effective investments, but a key objection from finance ministries is that the policy will require up-front financing which is not currently available from public budgets in most countries. So the EED is seen as an immediate cost, rather than a way of driving demand in productive assets which would save money at a time of high energy prices and increase activity in the depressed construction sector. Research shows that there is a large well of existing public finance at EU-level (EIB and EBRD) and latent demand among private asset holders which would invest in these opportunities if a pipeline of financeable projects could be generated through policy and financing mechanisms.

Intervention by Heads of Government nationally and at EU-level is needed to breakout of these vicious circles. Both those where finance is not flowing to projects due to a lack of effective policies, and where policy is not driving investment due to an absence of appropriate financing mechanisms.

Five packages are priorities for action to stimulate and reform key markets:

- **Energy Efficiency:** the EU needs to invest around €700 billion in order to reach its 20% savings target in 2020 but policy is currently delivering less than half of this amount. Delivery could be achieved through **implementation of the originally proposed national mandatory targets in the Energy Efficiency Directive** combined with **additional financing through the EIB** and commitment **to national-level energy efficiency implementation agencies** to aggressively develop financeable programmes. This should be combined with a push **to liberalise and remove restrictive practices in EU construction markets** as supply chain inefficiencies and fragmented markets are major barriers to accelerating energy efficiency investment.
- **Energy Infrastructure:** the EU needs to invest €500 billion on energy infrastructure to 2020, the majority in electrical distribution. Better interconnection will also accelerate market integration and liberalisation. Long distance transmission can be accelerated through introducing **stronger agreement to invest in projects of European priority in the Infrastructure Directive and increasing funding for grids in the Connecting Europe Facility (CEF)**. A new work programme should be agreed to **accelerate demonstration and delivery of Smart Grids, through financial support from the Sustainable Energy**

Technology (SET) Plan and CEF. Sustainable market demand for smart grid technology could be provided by a requirement to provide **open and fair markets for electrical demand response and further liberalise retail electricity markets** through expansion and further implementation of the 3rd Energy Package.

- **Clean Transport:** existing European vehicle standards are currently saving 0.5-1% of GDP in oil import costs. **Future vehicle emissions standards should be set ambitiously** in response to high oil prices in order to accelerate import savings and to incentivise **accelerated roll-out of electrically powered vehicles**. Incentives for **integrating smart grid and electric vehicles** should be increased through the SET plan and CEF.
- **Finance:** the **EIB should have its capital increased** to raise its capacity to borrow from financial markets, and implementation of **EU Project Bonds** should be accelerated to further leverage institutional investment into critical infrastructure. This financing should be **prioritised towards supporting private investment in energy efficiency, grid infrastructure and renewable energy projects** which risk seeing a drastic fall in available project financing in the coming years.
- **Carbon Markets:** the European carbon price has collapsed due to the economic crisis and the hangover of historic over-allocation. This has reduced government revenues, increased market uncertainty and threatens to move the EU off an efficient low carbon investment path. The most effective short term solution is to firm up prices by **“setting-aside” 1.1-1.4 billion ETS permits** in future auctions. This will result in an **extra €20-40 billion government revenue per annum** and increased private investment in the power and industrial sectors.

Driving effective growth requires a mixture of policy and financial interventions which can raise demand, remove market barriers and leverage private sector investment. A range of European low carbon policies are currently under development which could provide a real growth stimulus, if they can be strengthened and complemented by innovative financing and economic reform packages.

European Heads of Government are uniquely placed to draw these different processes together and give the political impetus to develop a comprehensive “green growth” package with significant short, medium and long term benefits for European citizens.