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POLICY MEMO

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Kurt Hübner
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June 2020

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ECSA-C Research Group: Political Economy

Led by Kurt Hübner, Jean Monnet Chair for European Integration and Global Political Economy, Institute for European Studies, University of British Columbia

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Challenges

Covid-19 urged governments around the world to inject vast sums of liquidity into lockdown-economies. Moreover, the reconstruction of pandemic-damaged economies requires further state support. The debate about appropriate recovery plans quickly became a debate about policy instruments and more so about the direction such programs should take. Climate activists quickly stepped forward by promoting the greening of state programs. As the political scientist Kathryn Harrison put it: "*This is a once-in-a-lifetime moment where governments are going to spend vast amounts of money. Let's not blow it by investing in an economy that we know we need to leave behind.*" Likewise, Bertrand Piccard and Frans Timmermans, the executive vice-president of the European Commission, stated for the EU: "*Instead of using the stimulus packages to support 'business as usual' – locking in obsolete economic models, and investing in assets that will soon be stranded – we should invest in the new economy to come out of the crisis in better shape than we went into it, fit for the future: sustainable, inclusive, competitive and prepared for the future: sustainable, inclusive, competitive and prepared.*" Such wishes are widely shared. As a matter of fact, using the necessary recovery programs as a lever for far-reaching climate policies plays a prominent role in many parts of the world. Whether it is the Democratic Party in the US, the Canadian Liberal Party or a large number of European governments as well as the EU, versions of a *Green Deal* can easily be identified.

Still, chances are, those big policy announcements will not live up to the expectations. The lockdown brought a slight reprieve to the increase of Co2. At the same time, the political preferences of voters shifted as the public has become more and more concerned about private and public health as well as economic well-being. We argue that a dose of skepticism holds for the marriage of the Green Deal-program of the EU and the 'Next Generation EU'-initiative. Four arguments drive this skepticism. First, the EU is running the risk to launch a cost-intensive program at a time when the rest of the world tries to rescue jobs and established growth paths. An un-coordinated policy comes with the risk of undermining international price competitiveness. Second, the experience of the rescue programs of the Great Financial Crisis from 2008 gives reason to doubt current announcements. Third, current liquidity and rescue programs drive public debt in new spheres and may provoke a new push for fiscal consolidation and thus austerity. Fourth, political majorities for ambitious climate policies compete with the demand to safeguard existing businesses and jobs. The more national governments focus on national interests, the higher the risk of turning towards protectionist practices. Rather than maintaining and nurturing the global public good, nation-states may try to improve their economic positions, probably with a dose of protectionism.

Green Deal and Trade

In January 2020, the new Commission of the EU presented its *'man on the moon'*-project, the *European Green Deal*. The Green Deal sets an EU-wide goal of net-zero carbon emissions by 2050 and a 50%-55% cut in emissions by 2030 (compared with 1990 levels). This ambitious target is reflected in the policies that make up the core of the Green Deal, which covers almost all sectors of member states' economies. The plan is not cheap, though. At least €1 trillion are proposed over the next decade, whereby €503bn should come from the EU budget, a further €114bn from national governments, and €279bn would be triggered from the private sector. Moreover, a €100bn "just transition" fund is offered for supporting the transformation of industries like coal and steel. When Covid-19 came along, the Green Deal was enveloped into the 'Next Generation Europe'-initiative that explicitly stated that the Green Deal would be

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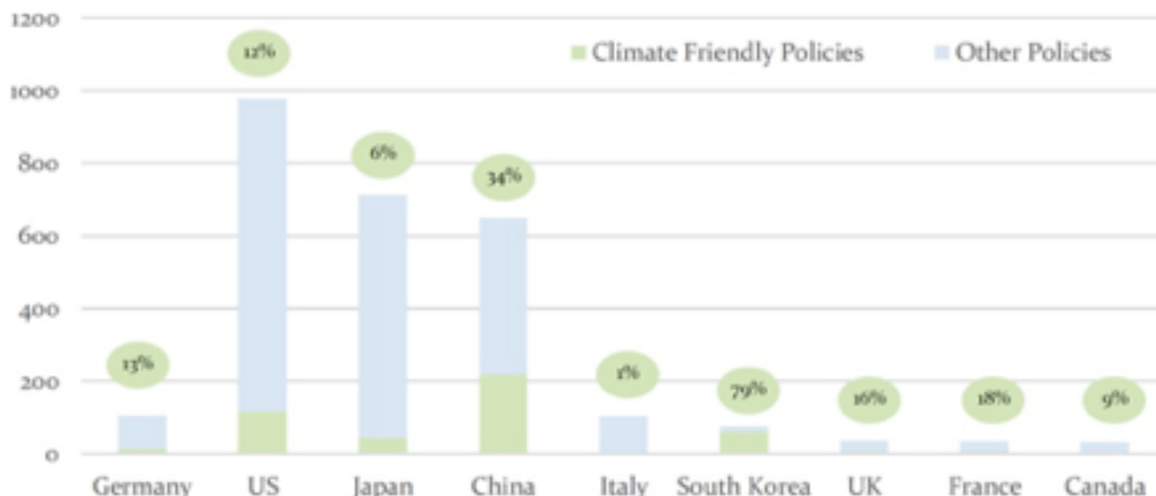
the critical recovery strategy of the EU to make its member economies more resilient and to mark the path towards a zero-emission economy.

From the very outset, the Commission realized that such an ambitious project might create price competitiveness problems if the rest of the world takes a wait-and-see-approach: Adding costs for producers and consumers to discourage high carbon-activities is a market-friendly instrument but also a tool that uses price signals for reallocating resources. Moving the EU on a low or even zero-emission path may generate long-term gains but also comes with the problem of short-term costs that may undermine price competitiveness of member states. To counter the problem, the EU – mainly featured by French President Macron – suggests the introduction of a border adjustment tax. Such a mechanism would levy an import tariff on goods and services of countries with a high carbon footprint, or exporters to the EU with a high carbon content would have to buy carbon allowances within the EU Carbon Trading System. At this point, the border adjustment mechanism is still a plan, and it needs to be seen whether the EU is willing to enter a fight with its trading partners, in particular the US, that considers this instrument to be a blank protectionist tool. In any case, the proposed date of 2023 for such a mechanism already indicates that the Commission expects political and also legal problems. This leaves the green recovery plan without a credential defence line against carbon leakages, and thus opens the door for actors who oppose the core of the project.

Past Experience

Enforced by twenty-six States in more than one hundred third The pusillanimous policy response to the pandemic has come with severe economic effects. Across the global economy GDP, economic growth experienced a negative shock with vast reductions of GDP. Unlike the global financial crisis of 2008, those effects were policy-induced. Still, in both cases, governments and central banks needed to come to the rescue by injecting enormous amounts of money into the ailing economies. Already the global financial crisis provoked a debate about the logic of rescue programs, where climate policy-activists argued to substitute ‘brown capital’ with ‘green capital.’ In terms of greening, the actual policy was disappointing, though (Graph 1).

Graph 1
Share of green measures in 2009 for G7, South Korea and China, In billion US dollars and percent
Source: Kröger et al. 2020 [1]



1 Mats Kröger, Sun Xi, Olga Chiappinelli, Marius Clemens, Nils May, Karsten Neuhoff and Jörn Richstein,: A Green New Deal after Corona: What we can learn from the financial crisis, DIW focus, No. 4 – May 11, 2020

Except for South Korea and, to some degree China that directed about 1/3rd of its recovery program towards green measures, OECD-economies were not investing in green sectors and activities. The worst case is Italy, that just 1% of its overall recovery spending directed towards climate-friendly activities. One of the most prominent programs in Germany, for example, was the 'scrapping premium,' nicely labelled 'environment premium' where car buyers got a subsidy for the purchase of cars with relatively lower carbon emissions. The standards were set so low, however, that more or less all cars qualified, and what sounded like an investment into the future turned out to be an indirect subsidy for the traditional automotive industry. In terms of climate policy, the rescue packages of the past indicate that it needs more than nominal spending programs to deliver turnaround policies.

Push Back: Fiscal Consolidation

Projections by the International Monetary Fund and the OECD indicate that by 2021, the GDP share of public debt in advanced economies will increase by at least 20 percentage points. At this point, rising public debt shares provide no economic problem, not least due to zero or even negative key interest rates. As long as interest rates stay at the zero lower bound, the financial burden of high public debt is manageable. The political acceptance of public debt shares close to or above 100% is a different story, though. A McKinsey-report expects that globally the rise in public debt will add about 2.5 trillion USD to the debt serving cost - defined as repayment of interest and principal - of governments. Economies with fiscal space will be in a better position than those with already exhausted fiscal space. For countries like Italy, Greece, and Spain, the challenge will be to navigate efforts to balance the books without undermining the social contract. Moreover, political pressure to relaunch the criteria of the Stability and Growth Pact will return, probably driven by the sentiments of the frugal four and its allies within the EU. The question then is whether the coming phase of fiscal consolidation will allow spending on climate policies.

Policy Coalitions

The immediate effects of the lockdown of national economies were staggering. Governments had to act quickly and decisively to avoid further havoc. It was not surprising then that the immediate liquidity provision packages very much benefitted traditional sectors without taking sectoral carbon footprints seriously into consideration. Reviving economic growth and re-creating jobs was seen as a crucial target to provide social stability and to foster effective demand. In some cases, this prerogative led to K-shaped early recoveries where a small segment of societies became winners, and a larger segment experienced a further deterioration of their economic status. If governments want to avoid a repetition of such a lopsided structure of the coming recovery programs, it will need adequate political support, and thus a political alliance of climate policy-oriented actors. Such an alliance is not out of reach, but it seems that any green social and political compromise needs time to emerge.

Trigger or Hindrance?

Political statements and plans indicate that the EU, as well as many nation-states, see the COVID 19-crisis as *the* opportunity to move their economies on a new developmental path. Rather than investing in carbon-intensive industries and practices, it is suggested to support carbon-neutral or low carbon activities. Whether this strategy succeeds depends on several factors, not least the willingness of governments to overcome the time horizon problem of climate policies where costs show up immediately and benefits later in time. One critical factor is the path COVID 19 takes over time: The longer the pandemic prevails, the higher the immediate economic costs, and the larger the political pressure to rescue existing lines of production and services. Whether such forces impact the spending behaviour of governments depends mainly on the strength of political climate coalitions and the way existing recovery programs are structured. The more clear-defined spending targets and criteria are established within the program, the less the chances of incumbent actors to redirect spending towards 'brown' activities. In any case, it seems reasonable to expect severe political struggles about the direction recovery programs will take.

Author

Kurt Hübner holds the Jean Monnet Chair for European Integration and Global Political Economy at the Institute for European Studies, University of British Columbia. His research includes global and European currency regimes, international regimes of foreign direct investment, and the relations between innovation and sustainability. His

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latest research focuses on the economic and socio-political foundations of technical innovations in a transatlantic perspective, and the ongoing processes of currency competition and currency cooperation (Euro-Dollar-Renminbi). Currently, Dr. Hübner is directing a project on EU-Canada as Global Economic Policy Actor, and recently he was part of a consortium on EU-North America-Asia relations. His most recent book publication deals with 'Europe, Canada and the Comprehensive Economic and Trade Agreement (Routldege).

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