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# Climate and Sustainable Finance

## The impact of the EU's energy transition

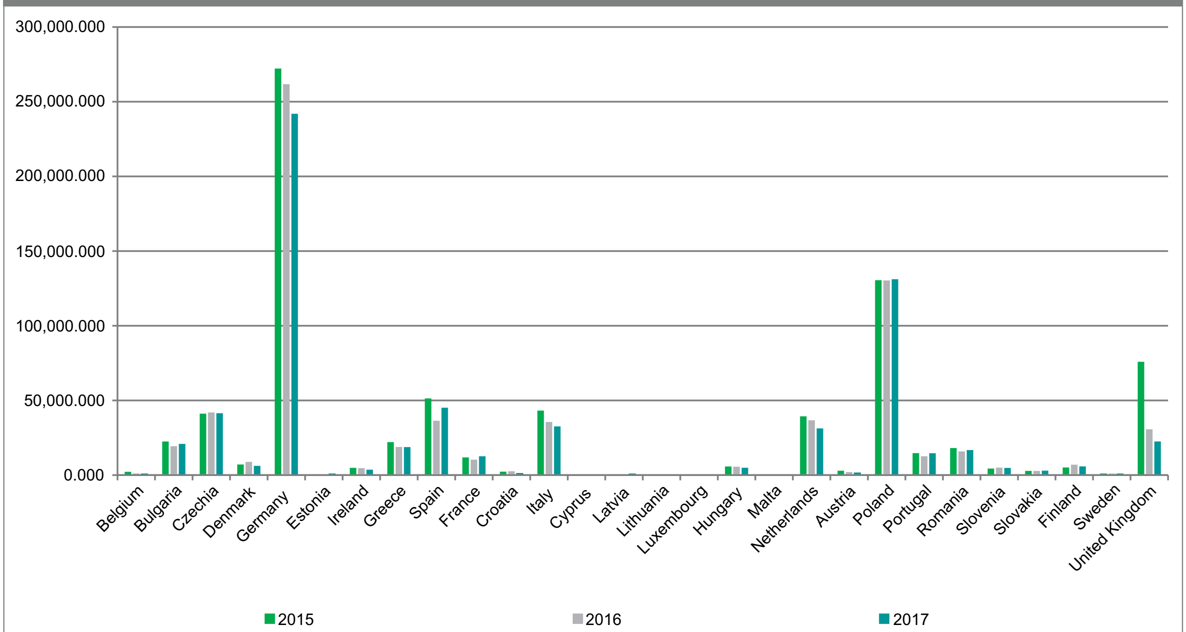
The Council of the European Union has agreed to cut net greenhouse gas emissions to zero by 2050, with support from EU member states excluding Poland. The plan has significant implications for the mining, transport, capital market, banking, and renewables sectors.

### Key findings

- The transition from coal to climate-friendlier assets is likely to vary, with Poland and Bulgaria less well prepared and Poland in particular likely to lag behind.
- Targeted EU financing for southern and eastern EU member states should help to reduce strike and protest risks in energy-intensive and carbon-heavy sectors.
- Implementation of the proposed carbon border tax is likely to be protracted because of technical difficulties.
- EU environmental and energy state-aid guidelines are likely to be changed.
- Protests by truck drivers are probable in response to likely taxation and regulation changes.
- Broader pro-environmental demonstrations are likely, including protests over the continued operation of coal mines, with a greater focus on coal in Germany.

European Commission President Ursula von der Leyen presented the European Union's "Green New Deal" on 11 December. This comprises a set of proposed policies and legislation seeking to overhaul EU institutions and to structure funding to catalyse "green" investments, ushering in a carbon-neutral economy. The cornerstone of the plan is a proposed law to make a target of zero net greenhouse gas emissions by 2050 legally binding. The plan aims to build on previous global and national initiatives, including the 2015 Paris Agreement and net-zero-emissions targets already introduced by Denmark, France, and the United Kingdom, to make Europe the first carbon-neutral continent. However, progress towards a carbon-neutral economy is fraught with political difficulties and has revealed a fault line between western and eastern EU member states. The EU's decarbonisation plan would damage coal-based electricity producers, as well as the automotive and other energy-intensive industries, particularly in Central and Eastern Europe. According to industrial trade unions, the transition therefore needs to be accompanied by measures to mitigate the effect on employment in affected regions.

**Gross electricity production from fossil fuels across the EU**




Notes: Gigawatt-hour
Source: Eurostat/IHS Markit

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Czechia, Hungary, and Poland argued that the EU must allocate additional financing to support the transition to a "climate-neutral" economy in their countries. Czechia and Hungary accepted the 2050 target announced by the Council on 12 December. Poland, however, warned that it still could not commit to the target. The Council will review the EU objective for a climate-neutral economy again in June 2020. In any case, the EU is likely to continue with its new policies, including new proposals to cut gas emissions.

To achieve its wider goals, the Commission's plan involves redesigning EU institutions and rechannelling EU funds to reduce the negative economic impacts of moving towards a carbon-neutral economy. Key policy instruments include the establishment of a "Just Transition Fund" (JTF), a carbon border tax, and changes to state-aid rules. The ultimate success of the EU's Green New Deal will also depend on its ability to export this model through a global strategy incorporating international development, aid, and multilateral mediation.

However, the scope of this special report is restricted to the internal challenges facing the deal.

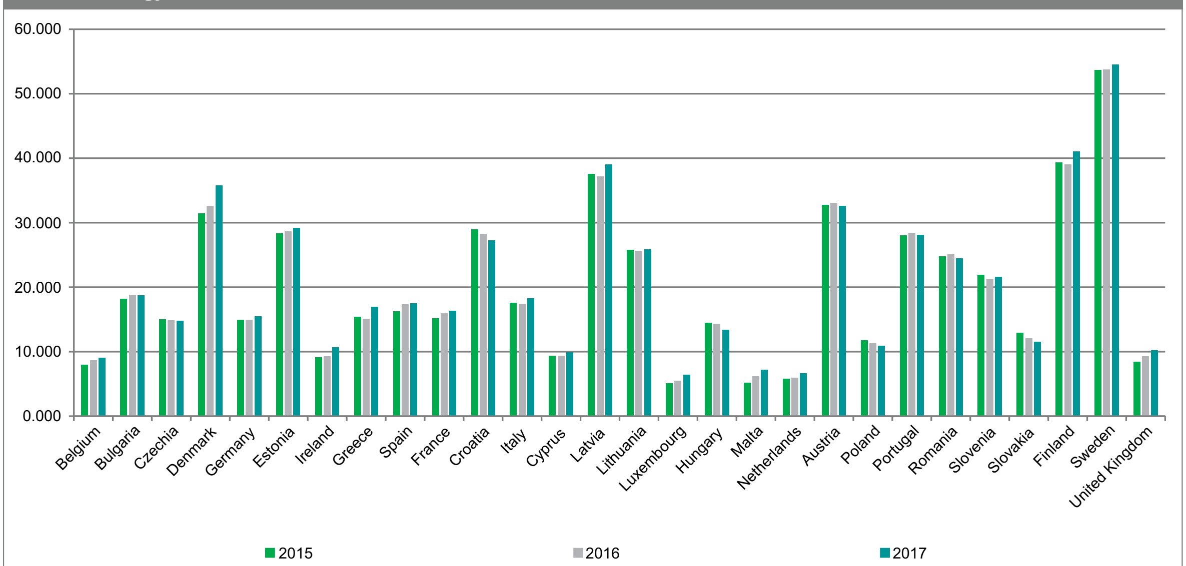
The JTF, envisaged ultimately to mobilise EUR100 billion, will be one of the key instruments in the EU's energy transition to a carbon-neutral economy. It is likely that it will predominantly support eastern EU member states, including Poland and Hungary. The fund, which will also provide technical assistance to streamline energy transition projects, is especially likely to benefit the transition of coal-based and carbon-intensive industries in regions that are already part of EU targeted initiatives. One such initiative is the 2017 knowledge- exchange "platform for coal regions in transition" involving regions from Czechia, Germany, Greece, Romania, and Spain. Regions in countries such as Bulgaria, Hungary, and Poland that have not been actively involved in climate risk mitigation assessment as part of EU-coordinated programmes appear less well prepared to utilise energy transition funds. They are also likely to require more time to implement policies that mitigate labour- market risks and increase labour availability for and migration to new industries such as renewables.

## Carbon border tax

If the EU is to achieve carbon neutrality, the price companies pay for greenhouse gas emission permits issued under the Emissions Trading System (ETS) will have to rise. This threatens to undermine the competitiveness of European firms, which risk being undercut by imports from countries without taxes on carbon. To address this issue, von der Leyen's plan includes a proposal for a "carbon border tax" (CBT). The CBT would aim to make competition between EU firms and international rivals fairer by counterbalancing the differential between the price of carbon in the EU and that in other countries and regions. Although the proposal is expected to enjoy nominal support from most member states, wholesale implementation will be technically difficult given the globalisation of supply chains, which means that the components of final goods such as cars are often sourced under different carbon-pricing regimes. Moreover, given the vagueness of World Trade Organization (WTO) rules on the subject, the risk of litigation would increase, with the EU's trade partners likely to accuse it of protectionism. For this reason, it is likely that the CBT would be introduced only incrementally, starting with the more-polluting products such as steel and aluminium.

## State-aid rules and support for renewables

Share of energy from renewable sources across the EU




Notes: In % of gross final energy consumption
Source: Eurostat/ IHS Markit

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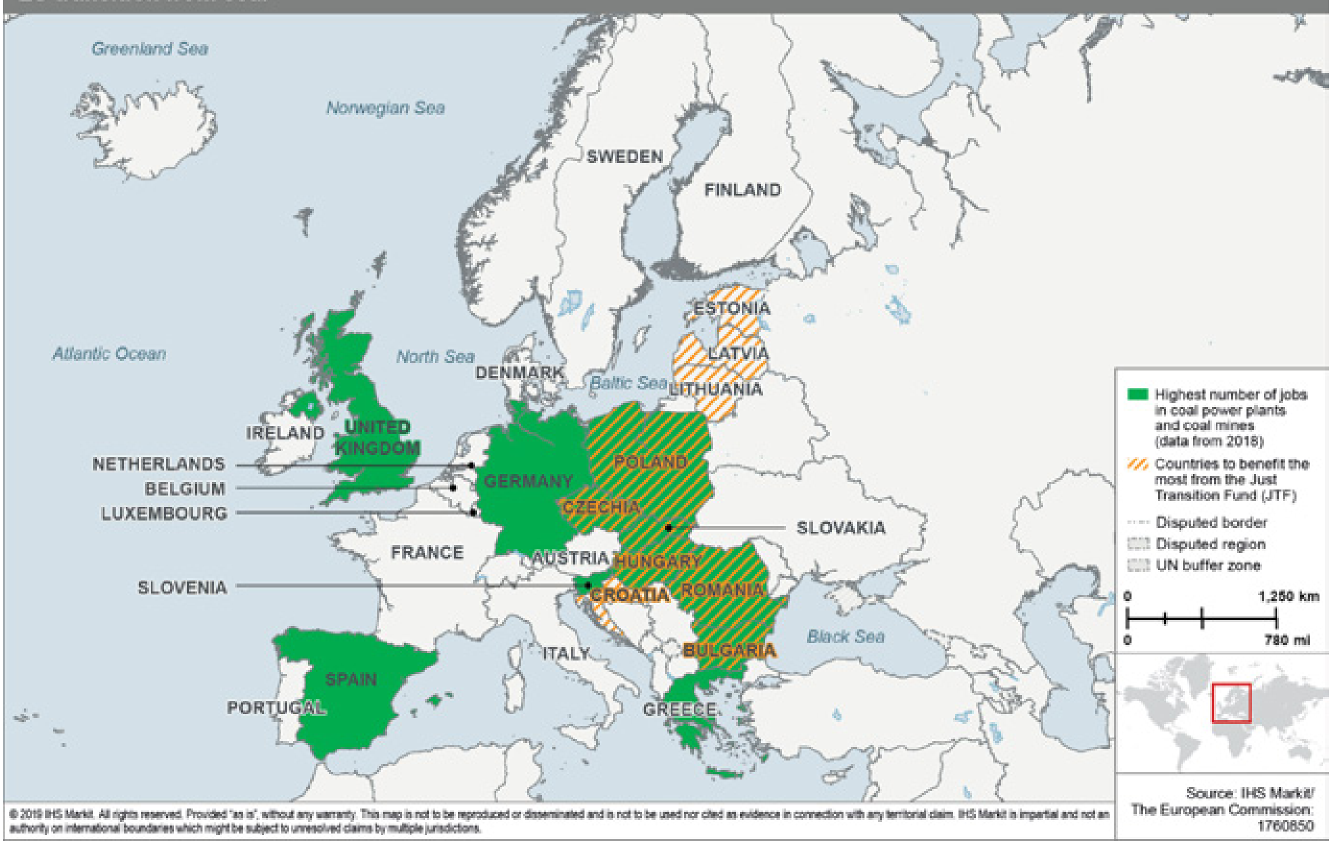
To augment the effect of the JTF and European Investment Bank green investments, von der Leyen has promised to review state-aid rules, specifically the environmental and energy guidelines, by 2021. The aim is to allow governments more discretion to support renewable and clean energy projects directly.

One likely measure is to exempt such support from the calculations of member states' budget deficits, facilitating a green stimulus that would greatly benefit the development of renewable energy and generate jobs. The precise definition of what constitutes "green investment" and can therefore be subtracted from the budget deficit would be key to the success of such a measure. Failure to produce an exact taxonomy would increase the risk of governments seeking to include other types of public spending under this category to circumvent EU spending rules.

Another potential measure to stimulate green investments is the pooling of resources to produce cross-border value chains. The Commission has already approved EUR3.2 billion of state aid for the research and production of sustainable batteries to meet consumer demands for electric vehicles (EVs). Active assistance for eastern EU member states, which do not enjoy the same level of hi-tech agglomeration as their northern and western counterparts, would be crucial to spread such cross-border value chains across the bloc. This would include helping such states with the proper utilisation of funds and encouraging labour mobility to generate knowledge spill-overs.

Solar and wind power plant projects are likely to receive targeted EU financing and assisted support from national governments in the next five years. However, discrepancies are likely to arise across the EU over the effective implementation of strategies to develop renewable energy generation projects and the utilisation of funds in areas such as reconverting mines to renewable energy sources. The time taken for individual labour markets to adjust will also be uneven, increasing the risk of strikes and industrial action in key sectors.

**EU transition from coal**



## Labour strikes and socio-economic protests

Targeted energy transition financing for southern and eastern EU member states in 2021–27 should reduce the risk of protests and strikes in coal-reliant sectors, but this reduction is likely to be uneven. According to the European Parliament, the decommissioning of coal mines would result in significant redundancies in Bulgaria, Czechia, Germany, Greece, Poland, Romania, Slovakia, Slovenia, and Spain. Plans envisage expanded funding for retraining programmes for coal workers, enabling them to be deployed in related industries such as renewables in coal-dependent regions.

The involvement of local authorities (such as in Czechia, Greece, and Slovakia) and of trade unions (such as in Greece and Spain) in programmes to phase out coal production should support a timely transition. For example, in September, Spanish trade unions succeeded in obtaining EUR250 million from the national government to fund workers' early retirement and retraining schemes related to the planned closure of 10 mines. Strike risks are also likely to remain low in Czechia and Slovakia, which have developed coal phase-out action plans at a national and local level.

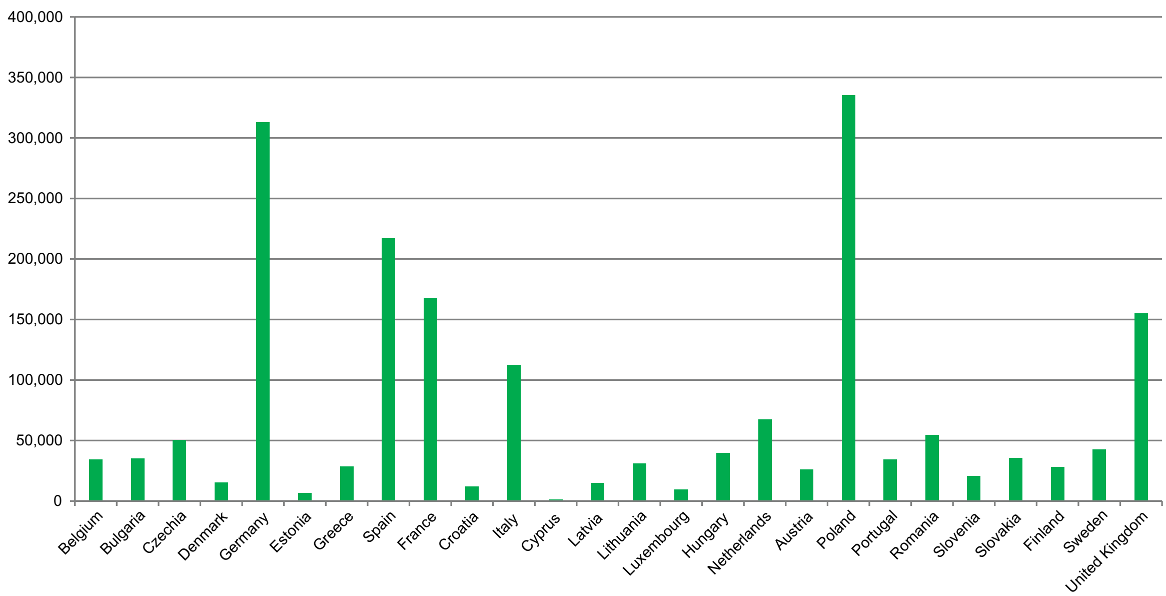
The risk of strikes is greater in Bulgaria and Romania, where the national governments have yet to prepare national guidelines, including timelines, for the phasing-out of coal. These may well be drafted in 2020, but administrative inefficiencies and probable poor dialogue with trade unions in both countries threaten to increase strike risks once specific phase-out plans are tabled. Strikes in Romania are likely to affect production at the Oltenia Energy Complex, which could be disrupted for a few days, as occurred in January 2019. In Bulgaria, workers in the mining and coal-powered industries are likely to organise short or day-long strikes and peaceful protests in Sofia, as in previous years.

The threat of protests and strikes by the very strong coal trade unions in Poland, which depends heavily on coal production, is likely to slow down the implementation of coal phase-out measures there. The risk of strikes in Poland's coal sector, low at present given the government's support for the sector, is likely to increase if the government, pressured by the rest of the EU, adopts concrete steps and a timeline to 2040 for the decommissioning of coal mines and coal-powered plants, or if the cost of coal production increases as a result of changes in EU-wide regulations. Strikes in Poland are likely to be peaceful, with initial "warning strikes" usually lasting a few hours. Protests would probably attract thousands of workers given the number employed in this sector in the country (coal mines in the Silesia region employ around 80,000 people).

The transport sector is also likely to attract increased attention within the climate-change policy debate. This is very likely to lead to changes in the next five years to the taxation and regulation regime affecting the transport sector and car manufacturing. The European Environment Agency has stated that harmful emissions from transport have been rising since 2014. EU policy-makers are likely to push for the adoption of lower carbon dioxide (CO2)-emission solutions in the transport sector, favouring EVs for public and long-haul road transport, while looking to reduce diesel and increase biofuel consumption.

The Commission has proposed the inclusion of road transport in the ETS. Given the complexities over who will bear the costs (car owners, car manufacturers, or fuel suppliers) and other related matters, the inclusion of the transport sector in the ETS is unlikely in the five-year outlook. However, this and other proposals to reduce the environmentally damaging impact of the transport sector are likely to prompt protests by road hauliers, especially those in international road haulage, in Bulgaria, France, and Poland. Road transport is particularly important for eastern EU member states such as Bulgaria, Lithuania, Poland, and Romania, while truck drivers have blocked roads over rising fuel prices in France and Portugal in the past few years, most recently in November in the case of the former. Eastern EU member states are also likely to attempt to block environmentally focused proposals affecting the transport sector in the European Parliament and the Council of the EU.

**2017 road freight transport across the EU in million tonne-kilometre (TKM*)**




Notes: **The transport of one tonne of goods over a distance of one kilometre
** Data for Czechia, Estonia, Spain, Italy, Lithuania, Sweden and the UK is from 2016. No data for Ireland and Malta (excluded from the chart).

Source: Eurostat/IHS Markit



## Environmental protests

The phasing out of coal mines and coal-powered plants is likely to be gradual and uneven across the EU. Spain, for example, has pledged to phase out coal completely by 2030 compared with 2038 in Germany, while Poland is more likely to table plans for closure after 2040. The governments in Poland and Romania are likely to delay any initial phasing-out plans beyond the five-year outlook to reduce the probable threat of protests and strikes. This, in turn, is very likely to prompt environmental protests against coal mine operations by international and local organisations such as Greenpeace within the next two to five years. In November, more than 1,000 protesters organised by the local “End of the Road” group disrupted operations at several coal mines in Germany. In May, Greenpeace activists protested in Warsaw over the Polish government’s lack of proposals to phase out coal, while in April hundreds of Czech, German, and Polish environmental activists demonstrated against the expansion of a mine in Bogatynia, Lower Silesia (Poland). Such demonstrations, attended by several hundred people on average, are very likely in Germany (across Brandenburg, North Rhine-Westphalia, Saxony, and Saxony-Anhalt) and, with smaller attendances and less frequency, Czechia (Prague, North Bohemia), Greece (Western Macedonia), Poland (Silesia region, Warsaw), Romania (Bucharest), and Spain (Castile and León region). Demonstrators are likely to block roads around coal mines and will occasionally provoke counter-demonstrations by coal miners, particularly in Greece, Romania, and Spain.

There is also an elevated likelihood of protests relating to hydropower plants. Environmental NGOs see such facilities as damaging to the environment and argue that they should not be considered as a source of green energy. Peaceful demonstrations against existing facilities or the development of small hydropower plants are likely in Greece, Portugal, Romania, and Spain. Environmentally motivated demonstrations against nuclear facilities are also likely, affecting Bulgaria (over plans for the development of a nuclear power plant at Belene), France (where there were protests in 2018 over a nuclear waste facility), and Poland (over plans for the development of a nuclear power plant, the location of which is yet to be determined).

## Outlook and implications

The Polish government is moderately likely eventually to support the 2050 carbon-neutral target. It is likely to take this step to qualify for funds for the modernisation of its industry towards climate-friendlier options and the mitigation of transitional social impacts. For Poland to take this step, it is likely to require assurance that it would receive funds from the JTF.

The Commission and the Council will decide in 2020 how JTF funds will be allocated. As the Commission plans to increase support from the initially proposed fund of EUR5 billion to undertake the mobilisation of EUR100 billion (through the combination of the JTF and a Sustainable Europe Investment Plan), it is moderately likely that coal regions in Germany, Greece, and Spain will also receive transition financing. Despite the potentially enhanced financial support, energy transition in Bulgaria, Poland, Romania, and, to a lesser extent, Hungary is likely to be slower than in the rest of the EU. This is because of a lack of clear climate risk-mitigation and coal phase-out plans; disputes with labour unions in the coal sector; a significant dependency on coal, especially in the case of Poland; and inefficiencies in the absorption of EU funds, especially in the case of Romania.

Moreover, the institutional capacity to absorb pooled resources to create cross-border value chains will vary significantly across the EU, making it likely that the innovation, development, and application of cutting-edge green technology will continue to be concentrated in western and northern EU member states.

If member states decide to allocate funds from the JTF in the same way that money from the Cohesion Fund has previously been apportioned, this would be likely to generate new variations between EU member states over the use of such funds. Bulgaria, Romania, and Slovakia have, for example, displayed a lower capacity to deploy EU funds than elsewhere within the bloc. If coal-dependent member states such as Bulgaria, Czechia, Poland, and Romania change their national energy plans in the one-year outlook to incorporate the 2050 net-zero target and clear intermediate goals, this would indicate a potentially greater preparedness to phase out coal power plants.

Environmental activism and protests are likely to continue in the coming years, especially in Belgium, France, and Germany. Such protests on the issue of climate change are likely to help sustain momentum for the implementation of the Commission's proposals, especially if they spread widely and on a large scale to eastern EU member states, including Bulgaria, Czechia, Hungary, Poland, and Romania.

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