Are European governments pushing for a green recovery?

Sustainability was already a hot-topic pre-Covid-19, but will this trend still continue or be abandoned? We focus on the European Commission's proposal and what is happening in the six largest eurozone countries and the impact on the automotive, construction and energy sector. It is still early days, but we think the green agenda is not being abandoned

Source: Shutterstock

Lockdowns obviously limit CO2 emissions. Aeroplanes don't fly, cars, trucks standstill and factories are closed. Research shows, 7 April was peak lockdown - the day that places accounting for 89% of the worlds greenhouse-gas emissions were in lockdown. On that day CO2 emissions were 17% lower compared to the daily average of 2019.

Even though this is the largest drop in emissions ever, it remains disappointingly low. Indeed, stopping the world economy is not enough to reach climate neutrality, which the Paris agreement aims to reach by mid-century. On top of that, it comes at an enormous economic cost and it severely hinders wellbeing.

On 7 April 2020 - peak lockdown day, CO2 emissions were 17% lower compared to the daily average of 2019

Before Covid-19, climate change and the trend towards a more sustainable world was already gaining importance. For example, the Eurobarometer from last March showed that 91% of European citizens find that climate change is a serious problem in the EU and 83% said European legislation is necessary to protect the environment.

And it seems that some existing trends that supported the green transition are reinforced due to the lockdown. If homework becomes a more important feature of how we work, then it could have a positive impact on CO2 emissions. Globalisation was also under pressure before the pandemic, and this could further increase due to value chain disruptions. This trend could also lead to fewer carbon emissions. On the other hand, during difficult economic times, consumers generally go for the cheaper option and finding other characteristics, such as the environmental impact, less important.

It is still too early to make a final judgement whether the economic recovery will be green. An important factor that could influence this is, of course, government action. In order to dampen the economic fallout of the Covid-19 crisis, governments have embarked in massive emergency plans, to help companies and citizens with the immediate negative impact of the crisis, and some have already communicated a recovery plan, to reignite and support economic activity after the economic shock. Given the trending importance of sustainability before Covid-19, an important question arises: "Will the recovery plan be designed to support both economic activity and the sustainability trend?" Or will the green agenda be postponed or even abandoned?"

In this article, we focus on the proposal of the European Commission and what is happening in the six largest eurozone countries. We also look at what the recovery plans mean for the automotive, construction and energy sector. It is still early days, but we have the impression that the green agenda is not being abandoned.

The European Commission's proposal pushes for green

At the end of 2019, the European Commission published its ambitious European Green Deal. The plan aims to transform the European economy to be climate neutral by 2050, which implies having net-zero greenhouse gas emissions. The Covid-19 crisis obviously interrupted this process, but did it also weaken the determination to make the green transition? The short answer is no.

About a month ago, the European Commission published its proposal, dubbed Next Generation EU, to reignite the European economy and the green transition is a crucial element. The proposal aims to "*kick-start the European economy, boost the green and digital transitions, and make it fairer, more resilient and more sustainable for future generations*".

The proposal would add €750bn to the European budget (about 5.4% of European GDP in 2019), making a total budget of €1850bn, and would be used over a period of four years starting in 2021 (there is also extra money for 2020, but this is based on the previous European budget). If the extra money is spread evenly over the four years, then the program equals 1.3% of the European GDP.

> *The proposal would add €750bn to the European budget (about 5.4% of European GDP in 2019), making a total budget of €1850bn, and would be used over a period of four years starting in 2021*

The extra money would be raised on financial markets by the European Commission and then distributed to the member states. €560bn will be given to the members' states in either grants (€310bn) or loans (€250bn) and €190bn is allocated to already existing specific European programs using grants (about €130bn) and guarantees (about €60bn). This extra money should be used in measures taken over the period 2021-2024.

On top of this extra money, the Commission also calculated that support via a number of investment programs could attract private money. The proposal, for example, cites that the 15bn from the Strategic Investment Facility, a program to support strategic investments in the EU which is part of the InvestEU program, could generate investment of over €150bn.

But it is difficult to quantify how much money goes to making the economy green
A crucial question is how much of this money will be used to support the green transition. This is a hard question to quantify.

First, the €560bn is allocated to the member states without an accompanying program. The proposal cites that money can be used to fund investment and reforms to make the member states more resilient. It adds that these investments and reforms should focus on the green and digital transition. But it also says it should address economic and social challenges that will be even more critical after the Covid-19 crisis in areas such as employment, education, innovation and health. So this part of the proposal will not always directly fund green projects. But importantly, the money cannot be used for projects that go against the green transition.

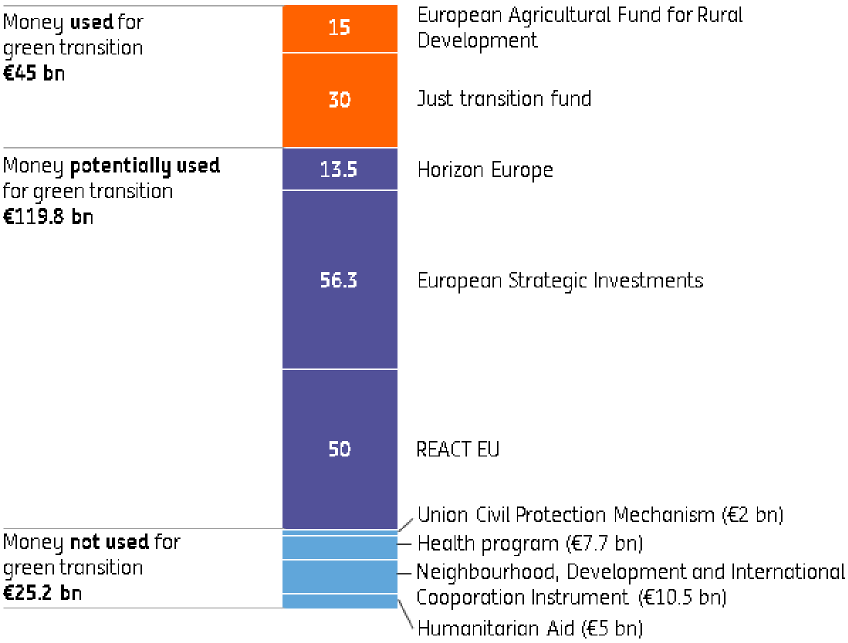
Concerning the €190bn already allocated to specific European programs, it is easier to judge whether it supports the green transition or not. About €25bn is allocated to programs that will have no direct impact on making the European economy green, such as defence or humanitarian aid.

The European Agricultural Fund for Rural Development program, in contrast, has the sole goal to support the green transition in the agricultural sector and rural areas. €15bn is added to the existing program bringing the total to about €90bn. This money should support farmers and rural areas to make the structural change necessary to implement the European green deal. The Just Transition Fund - a fund to alleviate the socio-economic impact of the green transition, can also be counted as 100% green. Re-skilling of workers, for example, and therefore keeping people employed should help to keep public support for the green transition elevated. €30bn is added to the existing program bringing the total to €40bn.

The remaining money allocated to specific programs could be used for the green transition, but it is not yet possible to measure how much exactly will be used for that purpose. The proposal mentions that these funds can be used for green projects, but other causes too. The Invest EU program, for example, can also be used for investments in artificial intelligence and the digitization of industry. The proposal, however, specifically cites a number of activities to invest in with the potential to get Europe's economy growing and making the green transition: large scale renovation, renewable energies and clean hydrogen solutions, clean transport, sustainable food and a smart circular economy.

€45bn goes directly to green projects

Part of Next Generation EU that is already allocated to specific programs in billions of euro that can be used over the period 2021-2024



Source: European Commission and ING calculations

How the money is paid back will also influence the green transition

At first, the extra money will be raised on financial markets by the European Commission and would be repaid after 2027 and by 2058 at the latest.

This makes it possible that national governments do not have to increase their annual contribution to the EU budget at a time when public finances are under severe pressure. On top of that, the Commission proposes new taxes on the European level that can be used to pay back the loans and so country contributions wouldn't have to increase by as much. The proposal also states that if these taxes are implemented before 2028, then the receipts will be used to lower the country contributions. We do not think, however, that these taxes will be implemented immediately. We feel that 2024 would be the earliest to see some new taxes. Companies, therefore, would have time to adjust.

Interestingly, some of the tax reform would influence incentives towards greener decisions.

Specifically, they propose a tax on non-recycled plastics, packaging waste and extending the emissions trading system-scheme by adding the maritime and aviation sectors. There is also talk of a carbon border adjustment mechanism.

Do the national governments also have a green reflex?

Germany
During the Covid-19 crisis, Germany transformed from the austerity champion to a big spender. After a massive emergency stimulus, Germany embarked on a massive recovery plan, worth €130bn or 4% of GDP. The key goal of the plan is to stimulate activity. VAT, for example, is lowered from July onwards until the end of 2020 to stimulate consumption.

But the plan also includes a number of measures that support the green transition. According to our calculations, about € 42bn could be used for the green transition. A big chunk focuses on the energy sector: Subsidies for renewable energy in 2021 and 2022 (€11bn) and to the development of a hydrogen strategy (€7bn). The car industry will be affected by measures worth €9.2bn. In particular, €2bn will be used to double the premiums to buy electric cars, from €3,000 to €6,000 for cars that cost up to €40.000 until the end of 2021. €2.5bn will be used to expand Germany's charging infrastructure for electric cars. Making buildings more energy efficient is also on the list (€2bn).

France
There is not yet a comprehensive recovery plan, although France already announced plans for three strategic sectors: aeronautics, automobile and tourism. Only part of these measures contained in these plans are new as they rely heavily on the instruments put in place earlier in the crisis.

Some of the support for these sectors supports the green transition but it is difficult to quantify how much will be allocated for the green agenda. The support for AirFrance (€3bn direct loans and €4bn credit guarantees) comes with green strings attached. The company should work to become the world's most environmentally friendly airline. The company should reduce its CO_2 emissions by 50% by 2024 for domestic flights, it should renew its fleet with more efficient aircraft and use more biofuel.

The French car industry receives an aid package of more than €8bn, with some support for the green agenda. The bulk of it, about €5bn, goes to Renault. The government wants that the company invests more in electromobility, even though there are no hard conditions. As in Germany, subsidies for low-emission cars are also increased and France will also invest in charging points. The conversion of combustion vehicles to electric ones will also be supported.

Italy
The discussions about a recovery plan are ongoing. An expert group proposed more than 100 projects, including green ones, but nothing is official yet. The difficult fiscal position, with a debt to GDP ratio of 135% in 2019 and forecasted to rise to 160% in 2020, makes the country reluctant to go on a spending spree. The funding of a comprehensive recovery plan would mainly have to come from Next Generation EU. The discussion about the allocation of these funds is ongoing, so it is unclear how much would go to Italy. But it is safe to say that these funds would not be used to go against the green transition as it is one of the conditions to receive the EU money. And part of it is likely to be spent on the green transition as this is also cited in the Next Generation EU proposal.

Spain

The situation is Spain is similar to the one in Italy. A reconstruction commission is currently discussion various proposals, but nothing is official yet. Financing would mainly have to come from Europe due to the difficult fiscal position. The structural deficit was estimated at 4% in 2019, which is the highest in the eurozone, while the debt to GDP ratio is also high (about 95% in 2019 and is projected to rise to more than 115% in 2020).

The Netherlands

The Netherlands has already announced a number of emergency measures, but there is no formal recovery plan yet. Normally, the government should present the budget for 2021 late September, which could include some measure to support the recovery. The fiscal position of the Netherlands is certainly not a problem to embark on an ambitious plan.

Before the Covid-19 crisis, however, the Dutch government already announced an ambitious climate plan that aimed at reducing CO2 emissions by 49% by 2030 compared to 1990. Among other measures, the plan would introduce a carbon tax for large companies. shut down coal-fired power plants. The crisis, however, has some impact on the implementation of the program and some measures, such as the carbon tax, are loosened.

The Dutch national bank, however, said that extra green investments should now be made. They also want financial institutions to bring their investment and credit policy more in line with the Paris climate agreement.

Belgium

Politically, Belgium is in a difficult situation. On the federal level, a care-taker government is currently in power and negotiations to form a new government are still ongoing. The care-taker government took a number of emergency measures, but there is no public information on a potential recovery plan. It is possible that it is part of the new coalition agreement currently discussed. On the other hand, the National Bank of Belgium communicated that a recovery plan in Belgium is not possible due to the difficult fiscal position.

The importance of green measures in the next coalition agreement will obviously depend on the parties forming the coalition. Time will tell if Belgium has the green reflex.

Germany takes the lead in supporting the green transition

	Recovery plan		Fiscal position	
	Already in place	Amount allocated to green projects	Debt to GDP ratio in 2019	Structural balance in 2019
Germany	Yes	€42bn out of €130bn	59.8	0.9
France	Partial	Not possible to quantify	98.1	-2.8
Italy	Ongoing	Unknown	138.8	-1.5
Spain	Ongoing	Unknown	95.5	-4
Netherlands	Ongoing	Unknown	48.6	0.6
Belgium	Unknown	Unknown	98.6	-2.6

Source: European Commission and ING calculations

What sectors will be affected?

Even though the recovery plans are not complete, there is already some indication on the sectors that could be more affected than others. Below we discuss the automotive, energy and construction sector. It is likely that three will play an important role in the green recovery.

Automotive
One could think that the sharp drop in oil prices due to the Covid-19 crisis hampers the incentive to buy a low-emission car. But a lower oil price does not necessarily imply low prices at the pump. In France, for example, the price of a litre of Super 95 was about €1.50 early March and declined to €1.30 by early April, a drop of 13%. The oil price, in contrast, fell from about €47 a litre to €14 over the same period, a drop of 70%. Indeed, high taxes on motor fuels limit the impact of an oil price shock. On top of that, once the economy gains strength the oil price should increase again. As people generally do not sell cars quickly, a short period of low oil prices does not impact the overall cost too much.

Moreover, Germany and France decided to raise the subsidies for low-emission cars and to expand the system of charging points. Spain, as the second-largest passenger car producers in the EU, will probably use the EU funds to support its car industry. If they use it to back the green transition, by also supporting electrification, then the EU will easily accept it.

On top of this demand-side stimulus, the sector is also pushed to produce low-emission cars due to new regulation. Indeed, from 2021 onwards, the average CO2 emission per produced car in Europe should be no more than 95 grams.

Electrification of the fleet was already one of the trends in automotive before Covid-19, and it seems that this trend is currently reinforced.

Energy
On the energy front, it is likely that some investment in renewable energy will be postponed due to the economic effects of Covid-19. But overall, we feel that the willingness to support renewables remains intact, on both the company and governmental level, even though it is too early to know if the support will be enough to reach the goal to become carbon neutral by 2050.

The European Commission, for example, does not backtrack on its commitment to making the European Union carbon neutral by 2050 and cites investments in renewables and hydrogen in its proposal. Germany also will invest €7bn in a hydrogen strategy.

Oil and gas companies obviously take notice of these governmental plans and push them to adjust. The economic impact of the crisis, on the other hand, also seems to accelerate their transformation. Mid-April, in the middle of the Covid-19 crisis in Europe, Royal Dutch Shell, for example, joined other energy majors, such as BP and Repsol, in announcing their indentation to become a net-zero emitter. The company also reinforced its commitment to lower the carbon intensity of its products. So oil and gas companies are not backtracking on their climate commitments due to the crisis. Moreover, a number of energy majors downgraded their oil and gas price forecast in the medium run, citing that the crisis will lead to lower demand for a prolonged period and that it will accelerate the shift towards cleaner energy. This led to asset write-downs.

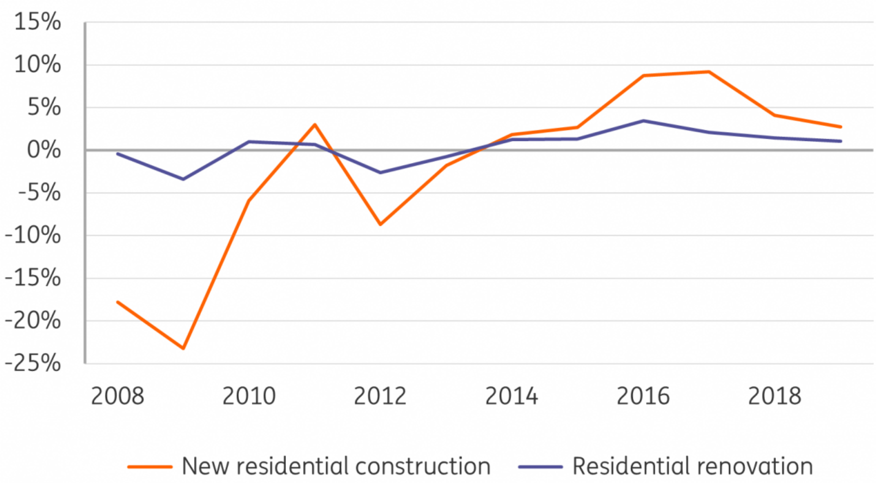
Construction

Modernising buildings and making them more energy efficient is one of the activities that would high impact on our CO2 emissions. And indeed, renovation is something that is supported in the recovery plans of the European Commission and Germany, and it is also part of the Dutch climate plan of mid-2019. Interestingly, it is a labour-intensive sector and so it would push up employment at a time when it is really needed.

It is indeed a promising idea, although there is one thing we cannot overlook. The renovation sector is generally less business cycle dependent than the new construction sector. During the financial crisis of 2008, for example, we saw new construction output drop significantly in western Europe, while the renovation sector did much better. Indeed, it is easier to postpone a new building project than a renovation of a leaking roof. This implies that stimulating renovation could lead to upward pressure on capacity in this specific segment and in turn on prices. Higher prices should, in theory, attract new companies into the sector, but this takes time. So one cannot expect this to be a quick fix.

New construction more cyclical than renovation

Development production volumes Western Europe (EC-15), % yoy



Source: Euroconstruct

The green agenda isn't being abandoned

After the emergency measures taken due to the Covid-19 crisis, more and more governments are investigating possible recovery plans.

An important question is whether these plans will give an extra stimulus to the green transition. It is still early days, but we have the impression that the willingness to push for a continued green transition is not hampered because of the crisis. The German plan has a large green component and the proposal by the European Commission does not show any signs of backtracking on their green agenda.

For some European countries, such as Spain and Italy, the difficult fiscal position makes it hard to have an ambitious recovery plan in general and therefore make it less easy to introduce new measures that support the green transition. But these countries could receive funds from Europe which could, in turn, be used to both support the economy and the green transition.

Even though there is still a lot of uncertainty, we can conclude that the green agenda is not abandoned due to the Covid-19 crisis and there is a chance that it will be reinforced.