Carbonfinance

Enlightened industrial policy for Europe via EU ETS reform

The EU's emissions trading system could be the catalyst for long-term economic growth and significant innovation in the European manufacturing sector, if reforms are undertaken, Tomas Wyns argues

The EU is currently facing multiple challenges on numerous fronts. Recovery from the financial, economic and sovereign debt crises is ongoing and the current economic conditions in Europe are taking their toll on the bloc's industrial activities, particularly with regards to new investments and access to capital.

The economic crisis has also exposed structural design deficiencies in the EU Emissions Trading System (ETS), to the point where a possible collapse of the pioneering carbon trading programme is actively discussed within the climate policy arena. Such a collapse would be devastating for European climate policy cohesion and for the political momentum towards the implementation of cap-and-trade systems outside the EU, as well as for the achievement of a global climate change agreement under the UN by 2015.

While enhanced climate action and economic growth often seem juxtaposed, we argue that a structural reform of the EU ETS could be the catalyst for long-term economic growth and dramatic innovation in the European manufacturing sector.

In our new report, *The New Deal: an enlightened industrial policy for Europe through structural EU ETS reform*, we propose a possible compromise that would mitigate most of the concerns about structural intervention in the EU ETS, in particular objections related to competitiveness. By mainstreaming industrial policy and innovation into European climate policy, the EU ETS could become an important tool for assisting structural economic recovery and the build-up of European competitive advantage in the new economy of the 21st century.

We put forward seven measures to mitigate the surplus of EU allowances (EUAs) in the system and align the EU ETS caps with the long-term EU climate goal to reduce emissions by 80-95% by 2050 compared with 1990 levels. For smooth structural reform, intervention needs to be implemented by 2015 and should not impact the political status quo regarding the level of free allowances for energy-intensive sectors up to 2020.

These seven structural reforms include the setting aside of EUAs, a price management mechanism, structural adjustment of the EU ETS cap towards 2050, a comprehensive assessment of competitiveness issues and earmarking revenues from EUA auctions to an industrial transition fund.

We think that this important new mechanism, an Industrial Low-Carbon Transition Fund, should structurally address the mid- and long-term challenges related to decarbonisation and competitiveness.

This fund would aim to assist the development of a new European industrial policy, broadly consistent with the European Commission's 2012 industrial policy communication 'A Stronger Industry for introducing Growth and Economic Recovery', and would bring the necessary funding for proper implementation of this industrial policy.

In line with this new thinking on industrial policy, we need a a holistic or broad-spectrum approach to mainstreaming industrial policy into climate action. This includes the following themes:

- **Process innovation,** with the goal of bringing low-carbon breakthrough processes to the market within the next 15 years;
- **Product innovation,** with the goal of increasing value-added in products essential to a low-carbon and resource-efficient society;
- **Value chain** and **business model transformation,** to further reduce emissions, enhance resource efficiency and find new and smart opportunities for energy-intensive industries in a mature market;
- **De-risking (venture) capital and debt,** as a tool to facilitate access to finance, promote entrepreneurship and accelerate the market readiness of low-carbon products and processes; and
- **Social innovation** to train and re-train the skills needed for the transition to a low-carbon economy.

Finally, to break the stalemate between the European Parliament and the European Council over the 2014-20 budget negotiations the EU's own resources should be increased, through the EU ETS and the above-mentioned 'Industrial Low-Carbon Transition Fund'. This approach has two clear benefits. First, it will not directly affect the budgets of the EU member states. Second, by earmarking funds for industrial innovation, it will safeguard the funds in the proposed EU budget aimed at stimulating growth and innovation. We estimate that between €10 billion-15 billion ($13 billion-20 billion) could be provided in this manner in the period 2015-20, rising to €18 billion by 2023. This figure could be even higher through the financial leveraging mechanisms offered by the European Investment Fund.

The economic crisis should not be used as an excuse to postpone structural measures leading to an enhanced EU ETS. Mainstreaming long-term industrial competitiveness into the EU ETS through the Industrial Low-Carbon Transition Fund offers the opportunity to do more than just fix the EU ETS: it could also transform the EU ETS into a tool that helps European industry build a competitive advantage in a global economy that will face more and more carbon and resource constraints over time. The EU ETS could then be a tool which finally serves the objective of decarbonising the European economy.

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