Berenschot

FORECAST

Pricing discussions continue: are emissions going to cost more?

Saying that it takes a crisis to achieve any major progress in European policy is stating the obvious. It first has to become abundantly clear that the best way to resolve problems is by taking action at a broader, European level before the individual member states will agree to grant the powers this requires. There has certainly been no shortage of crises in recent years. And now is no exception. But despite the different causes of these crises, they have all had one thing in common: each has triggered calls for greater government involvement, specifically at an EU level. And these calls have also resulted in significant intervention in the markets.

For many years the golden rule was that the European Commission's role was simply to create the basic conditions needed for optimal functioning of the single market. Various developments mean the thinking in this respect now seems to be changing. The crises in recent years have forced the Commission to take on a more active role in the market; indeed, we have seen more and more situations where legal action has been taken to force governments to intervene, and the balance between countries favouring a free market economy and those with a tradition of more active state involvement seems to be tilting increasingly towards the latter. One of the areas where this is becoming particularly evident is in the pricing of externalities. But before we look at this in more detail, let's first discuss how views on market intervention at a European level are changing.

During the corona pandemic the Commission played a leading role in procuring and distributing medical equipment and vaccines. But the lessons to be learned from this, particularly in the case of vaccines, are not entirely unequivocal. The EU was admittedly able to secure supplies of vaccines at an early stage, but it paid a top price for them. The investigation by the European Public Prosecutor's Office of the role played by Ursula von der Leyen in the vaccine negotiations also highlights the importance of clearly and transparently delineating the extent of any such interventions.

The next systemic shock – the war in Ukraine and the resultant use of gas supplies as a blackmailing tool – has since triggered wide-ranging discussions on the need to intervene in the highly commercialised energy sector at a European level. One of the most intensively debated issues has been whether setting a price ceiling would lead to sharp price fluctuations and increases that could eventually boomerang back on the European economy. The Netherlands and Germany in particular continued arguing for a long time that it was better, wherever possible, to avoid intervening in the market because of their fears that this would simply divert gas supplies away from the EU. Within the Commission itself, too, there was resistance to intervention, as demonstrated by the universal criticism of the Commission's own plans for a price ceiling.

But nevertheless the seed of cultural change that has been sown by the approach chosen for managing crises is being warmly welcomed in societies that are now gradually expecting more and more of their governments. And this change is one of the main reasons for governments being called on to intervene to protect citizens against what are known, rather euphemistically, as externalities.

More and more often, recourse to law will be sought as a means of forcing interventions in European markets, as we have seen in the Urgenda ruling in the Netherlands and the climate cases at the European Court of Justice. Activists have now clearly found their way to the courts.

On top of that, Brexit means that one of the louder voices among what was already becoming a quieter group of free market thinkers in the European community has now also fallen silent. For the Netherlands this certainly means a need to refocus, with the scales increasingly tipping towards countries with more of a tradition of intervening in markets and industrial policy.[1]

The climate crisis, the impact of which extends far beyond that of the corona or Ukraine crises, demands that action should be taken, including or indeed specifically at a European level. But the approach promoted by some countries is being driven by their fears of losing out to competition from elsewhere in the world. France, for example, is focusing, in a fairly classical way, on using subsidies to boost European industry. Its intention is to prevent businesses that have to incur costs to make their activities greener from offshoring to countries with less stringent regimes and also to boost the development of new, innovative technologies. However, the risk is that countries will compete with each other on who can offer the most attractive subsidies. And, as critics point out, many subsidies just end up being paid to the biggest polluters.

A more ambitious approach would be to focus on pricing externalities. Introducing a charge for emissions would create a financial incentive to pursue innovation and ultimately a completely circular economy. The hope is that having to pay higher prices for polluting products will result both in lower emissions and in changing patterns of consumption. The risk, however, is that such measures may just lead to highly polluting production processes being offshored to countries with less stringent regulations, as indeed already happens today.[2] Europe's ambition to halve its emissions will be meaningless if these emissions are simply exported abroad. The solution being sought, therefore, is for charges on emissions to be imposed at the EU's external borders. For climate reasons, Sweden, for example, which currently holds the EU presidency, is already taxing imports of goods based on emissions generated elsewhere.

1 Adviesraad Internationale Vraagstukken, Slimme industriepolitiek: een opdracht voor Nederland in de EU (2022).

2 Paul Schenderling (2022), Er is leven na de groei: hoe we onze toekomst realistisch veiligstellen.

So will ‘the polluter pays’ be Europe’s new slogan? Back in 2012 these were the exact words used in Article 191.2 of the revised version of the Treaty on the Functioning of the European Union. A recent study by the European Court of Audit showed that applying the principle of ‘the polluter pays’ is a way to achieve good progress in combatting the most obvious examples of soil and surface water pollution.[3] But also that this approach is far from effective: the clear focus on directly evident environmental damage means that much of the damage borne by society remains out of regulators’ sight. This is despite the fact that complying with this principle aligns with the Commission’s ambitions for the European Green Deal and the REPowerEU plan, as well as creating opportunities to protect European industry against unfair competition from China, but also the United States.

At the same time, by focusing more intensively on the ‘polluter pays’ principle, the EU is showing that European citizens’ wellbeing is at the heart of its activities, while also pre-empting possible criticism that the EU exists only for the benefit of businesses, and creating momentum for achieving an innovative, circular economy. Without financial incentives, a fully circular economy is unlikely to materialize spontaneously, even if it would ultimately eliminate the need to price emissions. The EU already adds a price tag to CO_2 and other greenhouse gases that can be expressed as CO_2 equivalents, such as nitrous oxide (‘laughing gas’), although not methane. However, this applies only in certain sectors. But while the EU’s ambition is to roll the price tag out to all other sectors, it still has a long way to go to achieve the objectives set in the Green Deal. And a bigger financial incentive could speed things up, at least in theory.

The debate on pricing externalities, whether those emitted in Europe or those priced at an external European border, is now in full swing. Last year, a public consultation asked for feedback on the European Commission’s polluter pays principle.[4] Since early 2023, the European Commission has been using the Product Environmental Footprint method to test whether claims of climate neutrality genuinely stack up. Over time, the introduction of the Carbon Border Adjustment Mechanism (CBAM) will also result in CO_2 emissions on imports being priced. It is not inconceivable that, in future, such a mechanism will apply to a broader range of emissions. Just think of the system for trading phosphate rights, and the Accountable Material Balance for nitrogen emissions that we are familiar with in the Netherlands. As our colleague Paul Schenderling regularly reminds us, this may be a solution for the climate change challenge, which by now extends far beyond dealing with greenhouse gas emissions.

In short, Brussels is paying increasing attention to the environmental footprint of consumer goods, and ensuring a fair division of the costs and benefits of the climate and energy transition is becoming an agenda priority. Meanwhile, Berenschot is keeping a close eye on developments in Brussels so that it can advise businesses and governments on the most appropriate strategy and governance ahead of forthcoming legislation and regulations and changes in grants and subsidy schemes.

Loek Luiten is consultant public administration and EU at Berenschot.
Any questions?
Please contact Loek via l.luiten@berenschot.nl

3 European Court of Audit, The Polluter Pays Principle: Inconsistent application across EU environmental policies and actions (2021): https://www.eca.europa.eu/Lists/ECADocuments/SR21_12/SR_polluter_pays_principle_EN.pdf.

4 https://environment.ec.europa.eu/news/making-polluter-pay-commission-seeks-views-eu-environmental-liability-laws-2022-05-12_en

Berenschot

‘BERENSCHOT, FOUNDER OF PROGRESS’

The Netherlands is constantly evolving. Major changes are taking place in society, the economy and the nature of organisations. As a management consulting firm we have closely followed these developments for 85 years while working towards a progressive society. The drive to make a meaningful and proactive contribution for people and society is part of our DNA and our advice and solutions have helped to make the Netherlands what it is today. And we don’t stop until the issue is solved.

Berenschot Groep B.V.
Van Deventerlaan 31-51, 3528 AG Utrecht
030 2 916 916
www.berenschot.nl