POLICYBRIEF
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GREENING THE RECOVERY BY GREENING THE FISCAL CONSOLIDATION

THE ISSUE

The long road to economic recovery from the COVID-19 shock is just beginning. European countries are considering how best to reboot their economies, with fiscal stimulus plans at the core of the consideration. Meanwhile, the European Commission has put forward its own stimulus plan. These stimulus packages will amount to several percentage points of GDP, and can therefore influence the future orientation of the economic system. For this reason, policymakers aim to incorporate long-term goals into recovery packages, most fundamentally a just transition towards a climate-neutral economy.

POLICY CHALLENGE

Amid the chorus of voices calling for the post-COVID-19 recovery to be a green recovery[1], it is often overlooked that a similar narrative was developed in 2008, as Europe and the world designed their recovery plans in the aftermath of the great financial crisis. The rationale for a green approach was clear then and is clear now: the disruption, in this case caused by the pandemic, offers an opportunity to build a new eco-friendly system, for the benefit of current and future generations.

But pursuing a green recovery might not be as straightforward as one might think. Trade-offs must be weighed between the need to provide a short-term stimulus to the economy and the need to address the long-term challenge posed by global warming. In the short term, there is a clear limit to the proportion of

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A wide range of policies can contribute to economic recovery. e decision on the right policy mix will depend on which programmes, the distributional e ects of stimulus measures should not be overstated. e big-envelope programmes in particular are typically temporary and only modestly redistributive (a six-month tax cut even of the most regressive taxes on the list of priorities) or education.

e next largest share (17 percent) came in the form of business support, typically accelerated payment of VAT refunds, subsidies and export promotion. In this category, some explicit greening might be possible, but governments will largely take a broad approach, hoping to protect as many jobs as possible. Finally, at just 5 percent in 2009-2010, labour-market policies are likely to make up a larger share of stimulus spending this time. ere are indeed many valuable jobs that can and will be created within green industries, but governments will want to match as many unemployed workers to jobs as quickly as possible.

Given the signi cant di culty associated with the explicit greening of a large proportion of recovery funds (ie everything outside of public investment), the most e cient tool to encourage broad cooperation in a green recovery will be strengthened e orts to increase the price of future carbon emissions. While today's carbon price a ects decisions on the use of carbon-intensive equipment, expected future carbon prices a ect investment and divestment decisions. e size of stimulus packages about to be unleashed within the EU, and the fact that many businesses will look to restructure their business models and supply chains, mean that now more than ever carbon prices can play a signi cant role in shaping future economic systems.

is is a key lesson from the response to the great nancial crisis, when rela

But as the allowance price is driven by the interplay of a relatively complex system, market expectations and political feedback loops, it will not be so easy to hit a concrete price target.

One solution, which implies a stimulus of its own, would be to enable the European Investment Bank to provide financial guarantees to private investors that a certain level of carbon price will be achieved in 2025 or 2030. This would set a soft floor price for the ETS (see Zachmann, 2013). The EIB would sell options that would pay out the difference between whatever the ETS price is in also reduce the extent to which certain member states can undercut those who are prepared to implement higher energy taxes. Member states with higher prices, which might now be hesitant about increasing such price di erentials within the EU (because of fears of lost competitiveness), would now be a orded more scope for increasing prices.

Revising the ETD will be complex and it will take time to nd a balanced, acceptable solution. But the European Council can already today commit to link a CO2-component in energy taxes to the ETS carbon price (probably with some delay for operational reasons). A credible announcement would give a strong indication to companies, nancial markets, administrations and households.

Figure 1: Energy tax revenues of EU countries as percentage of total tax revenues, 2017