

CHAPTER 9

The European Green Deal at the core of the EU's and EMU's sustainability

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1. Introduction

In more recent times the European Union (EU) has faced a succession of crises, of which the Covid-19 pandemic (which erupted in the beginning of 2020) and Russia's full-scale invasion of Ukraine (in early 2022) have been the latest. The pandemic crisis prompted a strong (government policy) response. This fact can be explained by the nature of the crisis and by policy learning during the previous crises and in their aftermath (Buti and Papaconstantinou, 2021; De Grauwe and Ji, 2020; Quaglia and Verdun, 2022). Also, there was a functioning banking sector, which has led to a swifter rebound in economic activity, whereas the combination of the two in turn prevented a new sovereign debt crisis (De Grauwe and Ji, 2020; De Grauwe, 2023, this volume). Europe thus came out of the pandemic strengthened, yet it had barely time to recover from an extraordinary effort and was, as a result, still in a rather fragile condition to respond to the next crisis, triggered by Russia's war on Ukraine (Jones, 2022). That said, on their part, EU institutions, notably the European Commission (less so member states), have played an important role also throughout the latter crisis.



Nonetheless, EMU's sustainability was again cast in doubt. This time the destabilizing situation was the result of successive delays in implementing the green – notably energy – and digital transitions, made much more acute by the effects of Russia's aggression on Ukraine. In the wake of the Ukraine crisis, by the end of 2022, high stagflationary risks had created major challenges for the good functioning (avoiding financial fragmentation/instability) and sustainability of EMU. There was a need for monetary and fiscal action within the appropriate EU (and also global) governance framework. It includes a role for world major central banks in engaging in close coordination of their actions to avoid excessive tightening of monetary policy (from July 2022 to June 2023, the ECB has increased its interest rate on the main refinancing operations by 400 basis points, from 0 to 4 per cent) with avoidable output and employment costs while credibly combatting inflation expectations. Fiscal policy also has a very important role to play, notably in improving the composition of public expenditure to turn around debt dynamics and speeding up the green and digital transitions (Buti et al., 2022).¹

One can hence argue that the succession of crises has made it ever more obvious that EMU's sustainability does not only depend on doing away with its own specific fragilities but that is also dependent on the broader EU (economic and wider) governance framework. Of course, the EU has faced and weathered crises before, but what is new is that crises have come not only to overlap but being intertwined. It follows that to be effective, policies more than ever need to address them simultaneously in a coherent and holistic way. Conversely, failure to push ahead with the climate agenda “will not only complicate the task of central banks, but will pose grave risks to economic stability and global well-being” (Gopinath, 2022). The ECB acknowledges that to finally implement that long-due EU priority would not only make the economy greener and less dependent on unreliable partners, but it would also reduce the risk of energy inflation (Lagarde, 2022).² It follows that governments should correct incentives and price in the negative

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- 1 Garicano (2022) argues that instead of reforming the Stability and Growth Pact (SGP), the EU should establish a new European Climate Investment Facility, given that the EU's current fiscal framework has failed to fully deliver long-term discipline and facilitate a countercyclical fiscal stance. This new facility would provide grants and loans to fight climate change until 2050, when the Union must reach net zero emissions. At the same time, an independent European Fiscal Agency would assess the good standing of member states to access this new facility. On the importance of a central fiscal capacity, see also Buti and Messori (2023, this volume).
 - 2 Attempts to reduce the risk of supply shocks (volatility) through the diversification of global trade and help boost potential output around the globe also need to englobe correcting market distortions by pricing in environmental damage and avoid (again) short-termism (Bongardt, 2023, this volume; Bongardt and Torres, 2023).

effects of carbon more effectively.³

2. The EGD as a third building block in the making of EU economic governance

The European Green Deal (EGD), presented in December 2019 by the von der Leyen Commission, is an expression of entrepreneurial spirit. It commits the EU to a profound change in policy direction towards more sustainability, namely to achieving a carbon-neutral Europe by 2050. It thereby gives rise to another qualitative change in European integration, after the single market and EMU, also Commission initiatives, had already shifted a trade-led to a European regulatory model and added a monetary union to the (still incomplete) economic union side. Both the single market and EMU enhanced economic sustainability, promoting efficiency through the competitiveness rationale in the single market and the (mostly but not exclusively microeconomic) benefits of a single currency. The EGD further enhances these goals, bringing in environmental sustainability and making climate neutrality a priority, and by including sustainability in the competitiveness rationale (now denominated ‘competitive sustainability’). It is hence not least due to efficiency considerations that climate and biodiversity need to be integrated into economics and be included in production and consumption functions and decision-making (Dasgupta, 2007 and 2021). As for EU-level coordination, and as the European Commission (2019b) and the ECB (2021a; 2021b) acknowledge, the chief rationale resides in avoiding negative spillovers from non-internalized environmental degradation into the single market and EMU. The European Commission has recognised the ecological constraint and adopted the EGD as the cornerstone of its economic policies (Schoenmaker, 2023, this volume).

There are two principal reasons why the EGD has the potential to become another building block of the EU economic governance. First, it is built on EU sustainability thinking that had been evolving over time, representing its (logical) culmination, as economic efficiency reasoning *per se* requires that environmen-

3 As put by Heemskerk, Nerlich and Parker (2022), this becomes easier as the pressure on fossil fuel prices subsides. Pricing in would also offer governments revenues to support the necessary green investments, a win-win situation. Cutting counterproductive subsidies is of course another.



tal effects be accounted for, too.⁴ The EGD gives consistency to what had been a piecemeal approach (Bongardt and Torres, 2013). Second, the EU could only ever hope for truly politically sustainable European integration if it put economics at the service of the EU integration project by adopting a wider sustainability perspective, also in regard to addressing its governance fragilities (Begg *et al.*, 2015; Nicolaidis, 2019; Bongardt and Torres, 2022a and 2022b). However, the EGD as a building block of the EU's economic model is still in the making. The implication is that in this initial phase it is still fragile (not consolidated) put to test in a crisis context when crises should be addressed through its lens.

The EGD's objectives follow up on the European economic (growth) agendas (Lisbon and Europe 2020 strategies, both forward-looking and with long-term horizons for reforms), in that the European economy and society are to become sustainable by transforming potential threats (climate and environmental challenges) into economic opportunities and by making the transition just and inclusive.⁵ The principal (and revolutionary) novel feature is the EGD's imposition of an overarching sustainability lens – climate neutrality – to all policies and policy areas and on the economy and society. The EGD is hence a change of paradigm like the single market and EMU, but unlike those it did not come with treaty change nor with new competences for the Union. The (steep) challenge that lies ahead is to bridge long-term goals with consistent policies and actions in the shorter term with a view to climate and environmental mainstreaming. Implementation of its ambitious objectives thus hinges on putting to good use the existing EU economic governance framework, most notably climate and energy policies, and on incremental change.

The EGD made a multitude of policies and instruments that had previously lacked coherence and a holistic approach subject to its climate law. It can build on some important previous developments, among which that environment policy and instruments – notably the creation of the EU-level European Emissions Trading System (ETS), a cap-and-trade instrument – had been brought ever more under an efficiency rationale since the internal market and in light of the EU's global climate leadership role. The ETS has fed back into internal policies

4 The crises have also had an impact on trade, calling for internalizing negative external effects from productive activity like pollution. Yet, if negative externalities are not priced in, there is a difference between private cost (market price) and social (opportunity) cost, which leads to excess consumption and production (an economic inefficiency).

5 For a comprehensive analysis of Lisbon and Europe 2020 strategies see Bongardt and Torres (2020b).

and member state targets.⁶ However, it had lacked an external dimension. In the absence of a worldwide carbon trading system or equivalent carbon pricing, an effective EU ETS risks creating a competitiveness disadvantage for certain European firms. The recognition of this fact led to the EU gaining another EU-level environment policy instrument, the carbon border adjustment mechanism (CBAM), to start operating in autumn 2023. The two – the ETS and CBAM – are interrelated: while the CBAM will also bring in revenue it is foremost about correcting competitive trade-related distortions (so-called carbon leakage) at the EU-border, brought about by EU climate policies, thereby protecting the economic and political viability of the ETS and the EU’s treaty-based polluter pays principle.⁷

With climate and sustainability promoted to an overarching rationale, all other policies need to be coordinated and legislation revised to fall in line with the EGD’s holistic sustainability objective and carbon emission targets. Climate policy (hard law) together with climate mainstreaming may create a constraint that helps to align other policy areas. International commitments, above all the 2015 Paris Climate Accord, add (self-imposed and voluntary) external constraints.

The EGD’s legislative agenda is ongoing. Still, it has already brought about several important changes. First, the Commission came to enshrine and adopt a wide (economic, social, environmental) sustainability lens already in the Annual Sustainable Growth Strategy 2020 (previously denominated Annual Growth Strategy). It emphasizes the multi-faceted role that environmental policies can play in regard to a sustainable economic recovery and employment growth, through resource efficiency and the circular economy but also others like environmental fiscal reform, including shifting the tax burden from labour (a good) onto environmental pollution (an inefficiency); Second, and although the EGD had drawn on – essentially unchanged – soft governance through the European Semester process, the climate law and climate and energy regulation work as constraints; Third, the EGD gained the extra financial component that it had initially

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- 6 The ETS is a market-based instrument with efficiency properties. Its good functioning hinges on an adequate carbon price and a competitive market setting. Subject to a cap to total emissions, the carbon price reflects relative scarcity (supply and demand). Carbon trading provides economic agents with an incentive to abate emissions and invest in more environmentally efficient equipment. The ETS was to become broader and more effective in its 4th phase (2021-2030), as part of the Fit-for-55 package (European Commission, 2021).
- 7 On the CBAM, see also Bongardt (2023, this volume). In December 2022, EU legislators reached agreement to equalise the price of carbon paid for EU products operating under the ETS and the one for imported goods. The levy will be launched on 1 October 2023. To avoid double protection of EU industries, the length of the transition period and the full phase in of the CBAM will be linked to the phasing out of the free allowances under the ETS..



lacked. The EU's response to the pandemic crisis gave rise to (substantial) funds earmarked for fostering the green transition as part of the Recovery and Resilience Facility (RRF) while it simultaneously hardened soft governance by introducing reform conditionality. In addition, the Recovery Fund, set up as a temporary institution, will be repaid through new EU own resources. Those are geared towards European public goods (environmental protection and other) and will create some EU fiscal capacity⁸ that, together with other dynamics in favour of sustainability at the EU level (monetary, financial, energy and trade policies), as discussed in Bongardt (2023, this volume) and Schoemaker (2023, this volume), and also the national and local levels, not only allow the EU to reinforce its environmental policy (through EU taxes or the CBAM) but also imply an advance in economic and political integration.

Last but not least, the EGD has the potential to contribute beyond environmental sustainability also to the sustainability of the European integration process as such. To the extent that it curbs negative spillovers and promotes synergies and European public goods, the EGD feeds back into and complements the qualitative changes that the single market and EMU made to EU economic governance and contributes also to economic and political sustainability. In sum, this third building block of EU economic governance could foster democratic participation (Nicolaidis, 2023, this volume) and is part of what Loukas Tsoukalis (2022) refers to as Europe's coming of age.

3. Does the 'crisis mode' contribute to reinforcing the EGD and to EU's and EMU sustainability?

Crises in the EU prior to the pandemic had deflected from the climate issue by pushing more short-term issues to the fore.

The 2008-09 financial and the 2010-13 sovereign debt crises are cases in point. Although sustainability and green growth were already objectives of the EU's economic agendas, the EU largely wasted the opportunity for a green crisis exit.

8 As pointed out by Cabral (2022; 2023, this volume) the EU has now 'a new centre of sovereignty on the fiscal/budgetary front, with respect to borrowing and tax competences'. Such a change re-balances EMU, contributing to a more efficient policy mix. Buti et al. (2022) and Buti and Messori (2023, this volume) put forward investment and reforms for sustainable growth as a carrot in the proposed new fiscal framework.

Still, financial restraints notwithstanding, that would have been feasible through existing instruments (regulation), with a view to incentivising sustainable behaviour and investment (Bongardt and Torres, 2016).

In the pandemic crisis, which allowed for establishing a conducive link between the short-term and the long-term and played to the EGD's economic rationale and policy priorities (Bongardt and Torres, 2022b), the same did not happen. The pandemic crisis has been made to work towards reinforcing the EGD. Policy responses could build on policy linkages, such as synergies between addressing climate change and Covid-19 (causes, policies) and also complementarities (digital transition). Environmental and social lessons arguably contributed to preparedness to modify unsustainable patterns of consumption and production in line with the EGD and long-standing EU priorities (digital, fair and sustainable economy).

The European Commission, which regained its leadership somehow lost to the European Council in the previous (financial and sovereign debt) crises, realized that the EGD could be framed as an exit strategy for the pandemic crisis (European Commission, 2020b). The EU's efforts to ensure a future-oriented sustainable, even, inclusive and fair recovery were therefore centred on the EGD and on investment.⁹ In addition, the EU's response to the pandemic also supplied resources – in fact, the EU's largest ever stimulus package. A large part of the recovery funds became earmarked for a green transition (European Commission, 2020b).

Likewise, the current security crisis, triggered by Russia's war on Ukraine, also had the potential to support the European Green Deal narrative and bring the green transition forward (Bongardt and Torres, 2022a). In the EU, sovereignty reservations have held back energy policy as far as energy sources (member states' energy mixes) are concerned. Yet, the war and its fallout have led, at least initially, to some preference convergence that has allowed for a larger consensus on the need to exit faster from fossil energy sources *cum* accelerating renewables. Visegrad countries toned down their criticism of the EU's climate policy once the Commission labelled the push for renewables, energy efficiency and emissions reductions as 'security policy'. At their March 2022 Versailles summit, EU leaders agreed to phase out dependency on Russian gas, oil and coal imports as soon as possible. In the wake of Russia's aggression against Ukraine, the RRF became the EU's chosen vehicle also to strengthen its strategic autonomy by diversifying energy supplies and ending the Union's dependency on imported Russian fossil fuels. In 2022,

9 https://ec.europa.eu/commission/presscorner/detail/en/ip_20_940



the new REPowerEU plan provided additional grants, allowing member states to add a new chapter to their national recovery and resilience plans as to finance key investments and reforms in line with its objectives.¹⁰

The ECB, in the monetary domain, has joined the European Commission in advancing the EGD as a third building block of the EU economic model. It has pledged to align its policies with the Paris climate objectives as quickly as possible, so that all the actions that it takes in the pursuit of its primary mandate will contribute to the greening of the euro area economies and not undermine incentives to accelerate the green transition (Schnabel, 2022). Its strategy review also depicts some entrepreneurship, as it enables the ECB to consider more deeply how it can continue to protect its mandate, strengthening the resilience of monetary policy and its balance sheet in the face of climate risks (ECB 2021a, 2021b).¹¹ The existence of climate externalities implied that the ECB had “to reconsider the notion of market neutrality”, as “in the presence of market failures, adhering to the market neutrality principle may reinforce pre-existing inefficiencies that give rise to a sub-optimal allocation of resources” (Schnabel, 2021). The argument is reinforced by Schoenmaker (2021), who shows that tilting the asset and collateral framework towards low-carbon assets (without undue interference with the transmission mechanism of monetary policy) reduces carbon emissions in the ECB’s corporate and bank bond portfolio by over 50 per cent.

As argued in Torres (2013), the ECB derives its legitimacy not only from delivering price stability, but also (its wider output legitimacy) from acting as a guardian of EMU objectives, doing “whatever it takes to preserve the euro” and guaranteeing the sustainability of EMU as such. The internalization of the need to contribute to reducing the costs of the green transition and help to ensure price stability in the long run has therefore come to be part of the main strategic objectives of the ECB. That is why the ECB has engaged with work on climate change, aiming at better managing climate-related risks, supporting the green transition in line with the EU’s net-zero objectives and fostering wider action from others (Lagarde, 2022).¹² As put by Isabel Schnabel (2023), “concerns that persistent higher interest

10 See <https://www.consilium.europa.eu/en/press/press-releases/2023/02/21/eu-recovery-plan-council-adopts-repowereu/>.

11 See also Schnabel (2021; 2023) and Lane (2022). Preunkert (2022) provides an excellent analysis of why and how climate change has moved to the centre of the ECB’s agenda.

12 Supporting the green transition is not a sign of dominance (see for instance Reis’s, 2022b, types of dominance – table 1) preventing the ECB from lowering inflation. See also Reis (2022a) and Schoenmaker (2021).

rates (monetary tightening) may discourage efforts to decarbonise (and thus increase the risks of “climateflation” and “fossilflation” affecting price stability) must be taken seriously – they expose a potential dilemma directly relating to the central bank’s primary mandate of price stability, that cannot be ignored even on legal grounds”. The ECB had already taken part in wider economic policy debates, such as on structural reforms. Supporting the green transition, it has brought in climate change into the debate and the discussions about its own course of action (and mandate).

In the end, to deliver price stability the ECB needs to take into account all factors affecting inflation and climate change is one of them.¹³ Besides the primary objective of keeping prices stable, the ECB’s secondary objectives, notably contributing to a high level of protection and improvement of the quality of the environment, are fundamental to ensure not only environmental sustainability but also the sustainability of the process of European integration and the very survival of EMU.

4. Like EMU before, the EGD is attracting fierce political opposition

Russia’s aggression on Ukraine led to the REPowerEU programme to accelerate the shift to renewables in the EU, yet the jury is still out on its net effect on the green transition. In an initial phase, securing energy supplies became a paramount concern. National governments invested in fossil-fuel infrastructure, reopening coal-fired plants and constructing liquefied natural gas terminals, which may lock in the usage of carbon-intensive fuels. Adding to that, the provision of energy price subsidies does not only contribute to higher public deficits, but it also masks the price signals given by changes in relative prices, which are however needed to incentivise lower consumption of fossil fuels, behavioural changes and greater investment in green technology (Heemskerk, Nerlich and Parker, 2022). Underpricing fossil fuels, as many governments in the EU have been doing, leads to overconsumption and global warming (Gaspar and Amaglobeli, 2023), prolong-

13 Frank Elderson (2023), member of the ECB’s Executive Board, goes even further: “Our economy relies on nature. Thus, destroying nature means destroying the economy. Preventing the former is in the realm of elected governments as nature policymakers. We as ECB have to take nature-related risks into account in the pursuit of our mandate”. As stressed by Dasgupta (2021): “(...) in recent decades eroding natural capital has been precisely the means the world economy has deployed for enjoying what is routinely celebrated as ‘economic growth’”.



ing non-sustainable consumption and production patterns and worsening global heating. The effects of all those misguided actions are to risk hindering the green transition whereas what is needed is an intensification of that process in order to reduce the costs of the transition and help to ensure price stability in the long run.

In a second phase, powerful vested interests, in various sectors – among which the German car and energy industry and the French nuclear sector – have been seizing on the crisis and its possible more immediate consequences (energy supply shortages, price hikes) as an opportunity to attempt to delay the EGD or even scrap it altogether. Of course, the implementation of the EGD's objectives is complex as it involves a whole legislative agenda to revise all EU policy areas as to ensure conformity. Member states have not shied away from trying to weaken it or take out pieces of the puzzle, even crucial ones (such as on channelling private funds to the green transition, transport or biodiversity), putting the achievement of targets and timings at risk.

Let us consider a bit more closely some recent examples that illustrate inconsistent behaviour on the part of member states. The EU Green Finance Taxonomy to guide investments towards sustainability, enacted through a delegated act, was seriously denatured when gas and nuclear energy were singled out and made subject to a separate Taxonomy Complementary Climate Delegated Act, in which they were classified as 'green' in the transition (driven by the particular interests of Germany in gas and France in the nuclear sector).¹⁴ In December 2022, Germany set a dangerous precedent by withholding its final agreement on the already agreed (also repeatedly by Germany) end of the combustion engine by 2035. Not justified on efficiency grounds and for the sake of a symbolic win for one specific party in the government coalition the German government was prepared to undermine trust in the political reliability of the country and the EU policymaking process. In June 2023, France followed suit by threatening a last-minute blocking of the approval of the EU's revised renewable energy directive, if hydrogen from nuclear sources was not considered renewable. The European Commission was forced to put forward an additional declaration acknowledging the role of nuclear energy,

14 After neither the Council nor the European Parliament (by absolute majority) objected to the Taxonomy Delegated Act, it entered into force on 1 January 2023. The new EU regulation classifies gas and nuclear energy, with high emissions from fossil gas and radioactive waste, as 'green'. It will therefore provide an incentive away from genuinely sustainable renewable energies, such as wind and solar power.

which Germany also came to back.¹⁵

‘Collusion’ between France and Germany (despite the Greens, who are however in minority in the government coalition), with various other member states, has also led to severely weakening the EU Biodiversity Strategy (*Financial Times*, 2023), an important element of the EGD, which called for binding targets to restore degraded ecosystems. Even the amended (weakened) version of the law was rejected by the environment committee in the European Parliament.¹⁶ In sum, out of electoral concerns but also in the name of resisting to change an unsustainable modus vivendi and production patterns (car, agricultural, nuclear sectors), various member states and established European political parties are ever more contesting the EGD (most recently on ‘red tape’ overregulation reasons). In this case, populist parties are following, not leading, the political opposition to the EGD but obviously it will be them who will capitalize on those short-sighted political stances, as is arguably already the case both in France and Germany. Moreover, those actions risk undermining the very EGD and, with it, EMU and the internal market.

5. Conclusion

The EGD, as a building block of EU economic governance in the making, is crucial to implement policies in a coherent and holistic way so that they are effective and the process of European integration sustainable (also from a political point of view). While an initial convergence of preferences made the EGD possible, the revision of all policy areas in line with the objectives and a conducive trajectory is proving a major challenge, above all because member state policies and actions are not consistent with the long-term policy objectives they had subscribed to in the first place. On the upside, EU institutions, notably the European Commission and the ECB, and some national and international institutions, have been re-

15 Interestingly, it was President Macron who had proposed Ursula von Der Leyen, who is also a member of the EPP and a German citizen, for President of the European Commission. She had to reach out to MEPs from other political groups (not counting with the support from the MEPs from Germany) to be elected in the European Parliament and the EGD is her own initiative. She has shown herself as a determined reformer and defender of the EU’s common interest and therefore, as already before in Germany, has attracted fierce opposition from her own political support basis.

16 Marking a new development in EU politics, a majority of MEPs in the EP seemed to have turned against (a crucial pillar of) the EGD. Still, in the plenary vote on 12 July 2023, MEPs did not follow party discipline and approved the (albeit weakened) law. European interest prevailed over party politics and populism.



sponding to the challenge by adapting rules and policies, which will have a positive effect in the long run. However, they also depend on the wider EU regulatory framework, for which the European Commission needs the approval of member states. Yet, national governments of some member states, most notably France and Germany, once considered the engine of European integration, and some mainstream European political parties have been turning against the EGD giving in to vested interests (and electoral tactics). Those policy stances are not only bound to feed Euroscepticism and backfire, but they undermine the EGD, EMU's sustainability and, in consequence, Europe's future and identity.

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