

EUROPE'S ENERGY UNION AND THE ROAD TO PARIS AND BEYOND

TOWARDS AN EU MODEL RECONCILING CLIMATE,
ENERGY SECURITY AND COMPETITIVENESS NEEDS



Final report of the Climate-Energy-Industry Working Group

Spring 2015

EXECUTIVE
SUMMARY

This report has been drafted on the basis of a series of meetings, discussions and written contributions from the members of the Climate-Energy-Industry Group, under the sole responsibility of Friends of Europe. The views expressed in this report do not necessarily represent a common position agreed by all members of the Working Group, nor the views of the organisations they represent, nor of Friends of Europe's Board of Trustees, members or partners.

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WHY THIS PROJECT MARKS AN UNUSUAL NEW DEPARTURE

This year is widely seen as make or break time for climate action. Global leaders have to meet the challenge of agreeing on an ambitious new international climate deal at the UN climate conference in Paris in December 2015. At the same time, concerns have risen over energy security because of the Ukraine crisis and turmoil in the Middle East, and the issue of Europe's failing industrial competitiveness has gained ground on the EU agenda.

The 'Energy Union' plan outlined in late February by the European Commission aims to address these issues, but it remains to be seen how it will resolve Europe's 'energy trilemma' by reconciling the competing demands of making energy sustainable, secure, and affordable.

Friends of Europe resolved in 2013 to address precisely this policy challenge by launching an innovative Climate-Energy-Industry Working Group, composed of senior figures from a broad range of backgrounds, including national policymakers, key EU officials, representatives from international organisations, financial institutions, civil society organisations, industry and academics. Their recommendations on how to create synergies between climate, energy and industrial policies, and on how to reconcile sustainability, security of supply and competitiveness, are contained in this report.

The Working Group members represented the full spectrum of divergent interests in the climate, energy and industry arenas, ranging from energy intensive industries, concerned that EU-only climate actions put them at a competitive disadvantage in the global economy, to climate and environmental groups that insist on the over-riding importance of halting climate change. A process of four open and constructive debates between Working Group members from November 2013 to June 2014 yielded draft text for their comments and amendments.

The risk of bringing together such competing interests in a truly heterogeneous group was that participants would do little more than state their own long-held views and disagree with those of others. To avoid this,

Friends of Europe broke the group up into smaller teams. While keeping the stakeholder balance, these enabled people to really work through the issues in detail and see how far seemingly divergent views could be reconciled.

The result was the emergence of far more common ground than many members had expected, instead of stereotypes and silo mentalities that are often seen as dominant characteristics of the climate-energy-industry debate. Two significant examples of convergence of views were on carbon leakage and national subsidies. Members agreed that carbon leakage – the risk of manufacturing moving out of Europe to countries with looser or non-existent constraints on greenhouse gas (GHG) emissions – would be bad for European industry and bad for the planet. With this in mind, environmental NGOs were ready to acknowledge the problems energy-intensive industries faced when confronted with higher energy costs than so many of their non-EU competitors and technical limits to major emission reductions in some sectors – and therefore the need for some carefully designed and targeted cost reliefs. In return, representatives of energy-intensive industries were more inclined to accept the overall ambition of EU climate policy. Likewise, both green and industry groups found common ground in agreeing that national subsidies and support mechanisms fragment the European energy market and add to costs, and should therefore be co-ordinated with a view to being phased out altogether.

It would be misleading, though, to suggest that the representatives of so many different interest groups were able to bury the hatchet on all topics. A glance of the members shows inevitable differences of approach, despite an overall mood of consensus and co-operation. That is why the Working Group proposals should be read carefully, as they contain the nuances needed to achieve the agreement of a majority of members.

The ideas from this unusual project spanning some 18 months have been distilled into 15 areas of agreement and 25 policy recommendations to the European Commission, the European Parliament and EU national governments. The message is clear: policymakers at all levels need to act urgently and in a much more co-ordinated way if Europe is to regain credibility and effectiveness. Public opinion as well as the relevant stakeholders must

get clear signals that the EU is serious about accelerating decarbonisation while boosting its industrial activity and guaranteeing long-term security of supply. Showing that reducing CO₂ emissions and strengthening economic growth are not mutually exclusive is, after all, the best way to encourage other countries around the world to follow Europe's lead.

We hope that this report will spark a new and more constructive debate in Europe.



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THIS REPORT WOULD NOT HAVE BEEN POSSIBLE WITHOUT

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**Positions are those held at the time of participation.*

EXECUTIVE SUMMARY

The Working Group's conclusion is that climate, energy and industrial policies can and must be mutually reinforcing, and that with better governance and the right policy mix, environmental sustainability, energy security and industrial competitiveness objectives can go hand in hand. But this will remain a distant goal unless today's policies are not changed.

Reducing emissions and tackling the effects of climate change are indisputably goals that should be pursued by all major GHG emitters. There is a limit to how much more carbon the world can or should emit and Europe must play its part in encouraging and leading the global battle to cut emissions both by its own efforts at home and by working to enact a global deal on limiting emissions. In order to be persuasive and credible on the international stage, our efforts at home must be seen by others as conducive to growth, not to deindustrialisation or carbon leakage.

Of course, despite its long-term benefits, the low-carbon transition has an undoubted immediate cost. The broad sense of our Working Group was that the current cost of climate policy can be reduced and should be borne by society as a whole, industry included. However, a carefully designed and targeted relief for low-income households, as well as for energy-intensive industries exposed to international competition, that would reward their R&D and resource efficiency efforts in the absence of a global climate action, is needed.

The silver bullet for reconciling climate, energy security and competitiveness goals is resource efficiency. There are huge opportunities to reduce use of energy and other materials year-on-year that will make the EU more competitive, ease the pressure of high prices, reduce our dependence on imports and cut emissions all at the same time. That is why the EU needs concrete action on energy efficiency and circular economy.

The focus of improving energy security and of reviving EU industry must be on introducing policies that are both climate and industry-friendly. This is entirely possible if Europe makes the most of what we have. For energy security, this means reducing reliance on energy imports by increasing domestic low-carbon energy production, diversifying supply sources, reducing energy consumption,

and expanding grids and interconnections. The energy dependence should not however be replaced by a reliance on imports of finished products.

For industrial policy, it means encouraging Europe's manufacturing sector as a whole, with a special focus on those sectors that are at the forefront of innovation, low-carbon technologies and resource efficiency. Among the specialities of tomorrow will be a range of new low-carbon energy and energy efficient technologies and applications, large-scale electricity storage projects and smart grids, but also new materials such as graphene, nano-materials and the whole range of key enabling technologies that make up the "Internet of Things".

There are currently too many industrial policies, in different sectors and across member states. The need is for an overall vision, something that is missing today.

A strong, innovative and sustainable industrial base and value chains are key for Europe's economic recovery, competitiveness and citizens' wellbeing. The industries on which Europe's prosperity has been built must contribute to the shared vision for the future. For example, Europe's coal supplies can play a role in its energy security, provided that only high-efficiency power plants are accepted and a way is found to reduce GHG emissions from burning coal (for example through carbon capture and storage technologies). The low-carbon economy offers significant opportunities for all sectors of the economy, including energy-intensive industries, to innovate, adapt more resource-efficient practices, and gain competitive advantages.

It is crucial and possible to decarbonise the European economy in a cost-effective manner. European industry has reduced its emissions very significantly since 1990. To ensure it continues to develop in a sustainable way, a reformed EU Emissions Trading System (ETS) must provide robust price signals that prices in the full environmental cost of carbon and discourages investment in high-carbon energy and consumption of high carbon products. The carbon market should be complemented by new financial instruments, such as green bonds, with strict EU standards, that offer a great opportunity to tap new low-interest sources of capital for low-carbon investment. Because of extremely low bond yields, financial markets are currently willing to finance over very long periods at low rates of return if private investments can be de-risked, securitised or refinanced.

Fiscal reform that shifts taxes from labour to environmentally harmful activities can be a powerful tool to support growth, innovation and employment, while contributing to environmental and climate goals. Carbon and energy taxes can incentivise investment, encourage fuel savings and fuel switching, drive consumer choices and reduce demand, and so improve energy security.

There is a great deal of uncertainty over costs in the energy sector, as fossil fuel prices are extremely volatile and technology change is making costs for emerging technologies hard to forecast. While it is important to pursue predictable policies, the lack of any sort of flexible mechanisms to respond to these fluctuations can and has already led to policy failures. For instance, the fixed price of the German solar subsidy resulted in higher energy bills as technology costs fell and deployment far exceeded expectations. Likewise, the fixed quantity ETS led to the collapse in carbon prices as the recession hit.

With a global climate action more urgent than ever, the EU should not abandon its climate ambitions. The low-carbon transition will be a long haul and the EU must play the leading role. To make the transition smoother, member states need to implement all existing EU legislation and coordinate their energy strategies. Pursuing unco-ordinated, unpredictable and inefficient energy policies, disconnected from citizens, will only increase costs, fragment the market, jeopardise energy security and discourage investment. Investors, as they sink their money into long-term low-carbon investment, will want a stable policy framework and the assurance that EU policy will not waver along the way.

15 AREAS WHERE THE WORKING GROUP MEMBERS COULD AGREE...

1. The evidence for man-made climate change is overwhelming and decarbonisation at an affordable cost must remain a priority for EU policymaking.
2. Failing to tackle climate change has a cost far higher than that of climate policies.
3. CO₂ emissions reduction and economic growth are not mutually exclusive, providing that reinforcing climate and industrial policies are put in place.
4. Only international climate action will create the same level playing field for all actors and help meet global climate change objectives. The EU must therefore push other countries for comparable climate efforts at the global level and for a new climate agreement in Paris in 2015.
5. The central pillar of EU climate policy should be an effective, well-functioning, and reformed carbon market, complemented by other financial instruments to finance low-carbon technologies, energy efficiency and energy infrastructure at a reduced cost, such as green bonds and public procurement.
6. Energy subsidies, for all sources of energy, should be phased out over time as technologies mature and become cost-competitive.
7. Energy efficiency is a silver bullet that can contribute to all three goals of EU energy policy: sustainability, energy security and competitiveness. The energy-saving and investment potential is large, in particular in buildings and transportation.
8. European overall economic competitiveness is influenced, but not determined by energy prices. However, low-income households, as well as a number of particularly vulnerable energy-intensive sectors, with high energy share in total production costs and exposed to international competition, need a carefully designed and targeted relief in the absence of comparable climate efforts undertaken in other major economies.

9. A strong, innovative and sustainable industrial base and value chains are key for Europe's economic recovery, competitiveness and its citizens' wellbeing.
10. Innovation and R&D are vital to Europe's future prosperity, and resources must be focused on areas such as low-carbon technologies, resource efficiency, energy storage and distributed energy.
11. The EU must diversify its external energy supplies and reduce its vulnerability to suppliers with dominant positions.
12. Consistent implementation of all existing EU legislation across member states should be a priority before introducing any new legislation.
13. The single energy market, once completed, should become a crucial tool to make it easier and less costly to decarbonise and to secure energy supply across the EU.
14. Member states should be given flexibility to implement their energy strategies, as long as they co-ordinate them, or even harmonise them, regionally and at an EU level.
15. The EU should develop a wide range of indicators to monitor progress towards energy, climate and industry goals, support future policies and show where to direct funding for R&D.

...AND A FEW WHERE THEY COULDN'T

There were some predictable areas of disagreement, including the energy-mix choices and new 2030 climate and energy targets. There was division on whether the EU should have confined itself to just one target (for emissions reduction); the need for a new renewable energy goal was particularly called into question. There was widespread agreement on the need to reform the carbon market, but little consensus on how to do so, with suggestions ranging from tighter allowances allocations for everyone and restoring the meaningful carbon price signals to more free allowances for energy-intensive industries to prevent carbon leakage.

25 RECOMMENDATIONS OF THE REPORT

These recommendations are principally based on the outcomes of Working Group discussions, and have been complemented by oral and written contributions from group members and other experts, as well as authoritative studies. They are not all consensual, but were supported by the majority of the Working Group members.

Reduce energy costs while ensuring energy security

1. Focus on low-carbon domestic energy sources, backed up by a pan-European energy market and upgraded infrastructure.
2. Develop renewable energy projects particularly in the countries where the cost is the lowest. The EU-wide nature of the 2030 renewable target provides an opportunity to achieve this.
3. Support energy efficiency efforts, research and innovation, and encourage demand side management, in both public and private sectors.
4. Use capacity mechanisms, coordinated regionally or at EU level, as a last resort to ensure energy security in the long run, but not to prevent inefficient power plants from being shut down.
5. Encourage member states to co-operate and co-ordinate their national energy policies in order to avoid 'beggar thy neighbour' policies and market distortions. This should include exchange of information, as well as coordination of projected investment in new production facilities and of national support schemes.
6. Identify and help the vulnerable energy-intensive industries exposed to competition from the rest of the world, in the absence of comparable climate efforts undertaken in other major economies. This carefully designed and targeted relief must focus on rewarding best practices and be co-ordinated at the EU level.
7. Keep energy users informed about the policies adopted and encourage their involvement.

(Re)invent industrial policy for the 21st century

8. Aim for a 20% share of the global market for goods and a meaningful share in global industry investment.
9. Ensure a top quartile performance in innovation, quality and environmental benchmarks.
10. Focus on encouraging production and development in Europe of future-proofed products and services and of smart and sustainable value chains.
11. Boost investment and innovation in key enabling technologies, as well as in areas such as smart grids, energy storage, low-carbon technologies, and resource efficiency.
12. Support R&D close to production and protect the intellectual property thus created in Europe.
13. Reshape the current industrial system to encourage more circularity and more collaboration across sectors and between companies.
14. Orient policy towards demand-side factors (mobility) rather than supply-side (automotive industry). In other words, think first about the nature of demand and then about new ways to meet it.
15. Do not protect free riders and unsustainable companies.

Create the right framework to finance the low-carbon transition

16. Reform the EU ETS in order to get the carbon price right.
17. Change the current system of free allocation for sectors at risk of carbon leakage in the absence of an international climate agreement from ex-ante historical production allocation to ex-post allocation adjusted to actual production.
18. Direct the revenue raised through the EU ETS to low-carbon and carbon-efficient projects and R&D, as member states are supposed to, but often fail, to do.

19. De-risk and reduce the cost of financing of low-carbon technologies, energy efficiency and infrastructure projects by supporting the green bonds market.

20. Use public procurement to encourage the purchase of low-carbon products and low-carbon consumer products.

21. Remove unnecessary policy risks from low-carbon projects while preserving the flexibility of future policy to respond to new evidence and market fluctuation.

Make better use of fiscal policies and fair trade rules

22. Shift taxes from labour to environmentally harmful activities. Careful and co-ordinated design and implementation of environmental tax reform is needed to avoid negative impacts on competitiveness and increase economic and societal gains.

23. Be transparent and strengthen EU oversight of national energy subsidies, and phase them out as technologies become cost-competitive.

24. Focus national renewable energy support on emerging low-carbon technologies and R&D.

25. Take measures at national, EU and international levels to counteract uncompetitive practices from the rest of the world, in particular with regards to energy-intensive goods imported into the EU, but without resorting to protectionism or violating WTO rules.

Read the full report at

<http://www.friendsofeurope.org/greener-europe/europes-energy-union-road-paris-beyond/>

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