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EU Climate Policy: The Climate Crisis Calls for More than Corporate Accountability

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Three years into the European Green Deal, its credibility is on the rocks. Investment in natural gas will be classified as "green" by the EU, a proposed social climate fund to support people on low incomes has been cut back, and regulatory nudges based on corporate accountability and reporting are preferred. If Europe relies on light-touch policies rather than real regulatory and fiscal measures to guide the private sector, the green transition in Europe will stall in the years ahead.

Since 2014, the EU has been strengthening the rules to make companies transition to more sustainable production models.

With the introduction of the Non-Financial Disclosures Directive for the first time, large companies had to report information on environmental, social and employee matters, respect for human rights, anti-corruption and bribery policies. However, the directive's scope was limited as it only applied to financial and large listed companies (about 11,000). The directive was unclear and lacked a mandatory reporting framework, making it hard for investors and the public to compare companies and for authorities to guarantee good reporting. In 2019, the EU published reporting guidelines on climate-related information, but they were non-mandatory. Studies have questioned the legislation's implementation and the quality of the disclosures.

More recently, the EU Commission published a proposal for a Corporate Sustainability Reporting Directive. The proposal extends the reporting scope of all large companies and all companies listed on regulated markets, except listed micro-enterprises. This could extend the application to over 50,000 companies. It also requires the audit of reported information and introduces mandatory reporting standards.

For the first time, companies will have to provide plans to ensure that their business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 degrees Celsius in line with the Paris Agreement. But how these plans will be assessed depend on forthcoming details from the Commission. If the Commission is to be ambitious enough, companies without a sound 1.5 degrees Celsius plan may be subject to infringement procedures – such a shift could constitute a historic advancement. However, since compliance and penalties are left to member states, it will depend on countries enforcing the environmental measures seriously.

Being compliant or even ambitious on Environmental-Social-Governance (ESG) reporting, does not mean that a company is sustainable. It just means it is transparent, that data is being analysed and reported. A fossil fuel company with no plans to transition to

sustainable activities could be an example of good reporting, whilst a solar panel company could be a bad one. The hope with this legislation is that when reporting data that is bad for the environment or human rights, companies will be subject to public, market, and political pressure to improve. Companies will also no longer be able to plead ignorance about their impacts.

But unless the European Parliament, the Council and then Member States push for clear criteria on the 1.5 degrees Celsius alignment clause or the consumers start prioritising sustainability in their choices, the incentive for companies to change might not be enough. After all, most large companies already publish ESG reports, but consumers are not aware.

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The limits of corporate sustainability

These two regulations are not the only measures put forward by the EU to support the transition to a sustainable economy.

To strengthen sustainability reporting in the financial sector, in 2019, the EU published the Sustainable Finance Disclosure Regulation. This regulation lays down harmonised rules for financial market participants and financial advisers on transparency regarding the integration of sustainability risks. The regulation's focus is transparency about the impacts of the financial sector with respect to the environment. The impacts of this regulation are still unclear, as the first implementation report is set to be published by the end of 2022.

Despite an expected positive contribution to transparency in the banking sector, the regulation does not set any specific goals or targets to improve sustainability in the sector. From a climate perspective, the direction in which the EU wants the banking sector to go should not only be transparency but mandatory action.

The same is true for the Taxonomy Regulation, published in 2020. It established the criteria for determining whether an economic activity qualifies as environmentally green for the purposes of determining the degree to which an investment is sustainable. It applies not only to financial market participants but also to certain companies (the same that are subject to the Corporate Sustainability Reporting Directive). According to the regulation, an activity is sustainable when it contributes substantially to climate change mitigation or adaption, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems. Even if the activity has a substantial contribution to one of the goals, it cannot do significant harm to others.

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In practice, companies will have to report which percentage of their activities are eligible and aligned with the taxonomy. The main goal is to provide comparable information to investors and the public. Compliant activities are eligible for green bonds and fund managers can market their portfolios as green. However, the regulation does not set any mandatory target for Taxonomy alignment, which means that companies can still maintain zero green alignment and, if the markets or the consumers, are not demanding enough, polluting activities could still go on and get funding, just not “green” funding.

In a devastating blow to the credibility and possible impacts of the taxonomy, the Commission and the Parliament agreed to classify natural gas and nuclear energy as green energies. Although we could make the case for green investments into nuclear fusion technology, as opposed to nuclear fission (current nuclear plants), classifying natural gas as sustainable is as credible as classifying fries as a salad. As previously explored with respect to the REPowerEU programme, the EU plans to invest in new natural gas infrastructure at the same time as aiming to phase out this fossil fuel by 2050. Some NGOs and scientists are even calling for a natural gas phase-out by 2040 or 2034. The sunk cost of new projects risks hindering climate performance for the next decades and compromises the Green Deal. Scientists, activists, and politicians know this and that is why some member-states and NGO’s are taking legal action against the taxonomy. Overall, the classification has undermined the credibility of the Green Deal as a whole.

Another important recent proposal is the Corporate Sustainability Due Diligence directive. According to the proposal, companies will need to develop due diligence policies across their supply chains to identify, prevent, and mitigate potential adverse impacts. In short, it means that companies could now be legally accountable for environmental damages and human rights infringements linked to their suppliers. In a best-case scenario for the regulation, a European garment brand that produces its clothes in Bangladesh would have to guarantee that no child labour or environmental damages were involved.

It is yet to be decided but the proposal may also oblige companies to adopt a plan to ensure that their business plans are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 degrees Celsius in line with the Paris Agreement and its clear when it states that carbon intensive companies should set emissions reduction goals. The directive has the potential to transform businesses but we’re currently waiting on Council and Parliament negotiations as well as a delegated act with more details on reporting. This wait may be longer than anticipated, since the draft proposal was also delayed for months. It is expected that companies and member states will lobby hard to water it down.

How do the EU’s efforts to green the economy stack up when assessed collectively? Simply put, while the proposals have some promise, crucial elements are missing. From making sure that the polluter does pay to ending fossil subsidies, fiscal policies need to be central for the Green Deal to be a success.

The polluter must pay

The first one is the effective implementation of the polluter pays principle. The polluter pays

principle is a simple idea at the core of EU environmental policy: those responsible for environmental damage should pay the costs. Despite being introduced by the Single European Act, in 1986, it still does not apply to all industries and fully within industries.

Implementing the polluter pays principle would mean environmental externalities would be priced within all products, at the full social cost of carbon. It would be a paradigm shift for our economic model. With such a policy, responsible products would become cheaper over time and unsustainable ones would be priced out of the market.

In practice, life-cycle assessments should be mandatory for all products on the market or, more reasonably, all products placed on the market by large corporations. The scope of such rule could be similar to the Corporate Sustainability Reporting Directive. By getting verified life-cycle impact of products, the EU could develop a model of "true pricing".

A "true price" is the market price plus the social and environmental costs of a product. Products on the market would have a true price tax, making the polluter pays principle effective. This model is already being experimented by a store in Amsterdam and should become the norm. For example, at the True Price store, jeans cost 40 euros plus 33 euros more, a t-shirt cost 15 euros plus 8 euros, a chocolate bar 2.79 euros plus 90 cents, a café latte 3.50 euros plus 25 cents, and a loaf of bread euros 3.25 plus 18 cents. The price difference is significant but depends on each product. Over time, true prices should go down as responsible, environmental, and social practices become the norm. From a social justice perspective, this model raises questions and that is why it could only be implemented as part of a strong social and environmental package, especially at a time of rising prices and inflation.

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We've seen how unpopular green measures can be in France in 2018 and right now with the Dutch farmers' crises. However, the Green Deal was conceived in a very different global environment. As it stands, especially after labelling gas green, it may no longer be fit for purpose. From the start, the social ambition of the Green Deal seemed scarce with an underwhelming Social Climate Fund and Just Transition Mechanism that not only was underfunded but also had regional cohesion issues and left crucial sectors, such as agriculture, out of the picture. Germany's decision to lower the budget for the EU's Social Climate Fund from 72 billion euros to 59 (against the will of the Greens) will negatively impact the lives of millions of Europeans and possibly turn the Green Deal into a crumbling house of cards.

Precisely because of these difficulties, re-opening the discussion on fiscal measures as well as the broadening of social measures should be on the table. Policies such as the 9-euro ticket in Germany or free rail transport in Spain, paid for by a windfall tax on extra profits from energy companies, could and should become European approaches.

Similarly, a true price model should be implemented with corresponding reductions in income taxes, especially for lower and middle classes. Higher prices would thus be compensated by higher income to support the shift to reduced environmental impacts. True pricing would also gradually eliminate "green premiums", the additional cost of choosing a greener option. For example, when we pay more for solar energy than coal, for a plant-based burger than a beef burger, for a train ticket than a flight.

An easy ride for fossil fuel companies

On top of implementing the polluter pays principle, there are other, more politically acceptable, short-term measures that could also have significant impacts.

First, ending all tax breaks and subsidies to highly polluting industries.

Starting with energy, according to a European Court of Auditors 2022 report, "Even though renewable-energy subsidies almost quadrupled over the 2008 to 2019 period, fossil fuel subsidies have remained relatively constant over the last decade". The report found that fossil-fuel subsidies were estimated at around 58 billion euros in 2008 and 56 billion euros in 2019, whilst renewable energy subsidies went from 20 billion euros to 78 billion euros in the same timeframe. Fifteen EU countries spend more supporting fossil fuels than renewables. The Commission has set the target to phase-out fossil fuel subsidies, including tax-brakes, by 2025. It is unclear how this will be achieved, especially since, in 2022, some States have increased support for fossil fuels.

The report is also clear that carbon taxes on fossil fuels are still too low. The European Court of Auditors found that more polluting energy sources get a tax advantage compared with others with better carbon efficiency. Coal, for instance, is on average taxed less than natural gas, which is more carbon efficient. Some fossil fuels are taxed less than electricity, which could be produced by low-carbon sources. According to OECD, in order to achieve the Paris goals, carbon should be priced at around 120 euros per ton of CO_2. However, the European Emissions Trading system has never reached such a high level and no EU country taxes at that level. The highest tax can be found in Sweden at 108 euros per ton, followed by Finland at 62 euros and France at 44 euros. The rest of EU countries tax below 30 euros per ton, a level considered insufficient to trigger meaningful change.

The report also found that carbon taxes are only applied to a minority of emissions. The highest percentage can be found in Ireland where around 49 per cent of emissions are covered, then Denmark and Sweden at 40 per cent, followed by Finland and France at 36 per cent and 35 per cent, respectively. The broadening of the Emissions Trading System to transport and other industries, and the proposed Energy Taxation Directive may address some of these issues, but within a timeframe of less than a decade, it might be too little, too late.

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Agriculture is another sector that has been exempt from the polluter-pays principle, especially livestock production. The livestock sector may be responsible for 17 per cent of total EU greenhouse gas emissions, but not only it is exempt from the polluter-pays principle, but it still receives about 32 billion euros in subsidies every year. Since 1985, the Commission has asserted that agriculture cannot be above the polluter pays principle. Despite this, the new Common Agricultural Policy (CAP) and Farm2Fork strategy still do not plan to reduce subsidies or levy environmental taxes. In fact, CAP spending on environmental measures might be overestimated. According to a European Court of Auditors report, for the 2014 to 2020 budget, the EU overstated 72 billion euros in environmental spending, 60 billion euros of which in the CAP environmental measures.

As of now, the incentives for companies to transition to sustainable production are mostly left to the market. If consumers demand more, companies do more. The problem is that most consumers base their choices on price. This leaves companies with little room for acting on sustainability unless competitors also change. A good way to incentive good corporate behaviour would be to simply lower taxes on sustainable products and sustainable companies, thus rewarding them for taking action.

A major step in this direction is the new VAT directive that allows States to eliminate value-added tax on some products. However, further integration of EU countries towards a fiscal union could set mandatory taxes for some products and completely exempt products such as solar panels, bicycles, public transportation, vegetable protein and even repairs. It could also increase taxes on products with high environmental impacts. At the same time, a deeper fiscal integration could create a tax system where responsible companies have lower tax brackets. This could be assured by certifications, audits, continual improvements, and other mechanisms, thus benefiting the best performers.

Saving the credibility of the Green Deal

The EU is taking major steps to make companies more sustainable and the economy greener. However, most regulations are focused on price signals and lack positive incentives, clear goals, and serious sanctions for non-compliance. Measures are mainly focused on transparency through reporting behaviours and environmental KPI's, but there is not even a legal requirement to improve this behaviour.

The hopes that the market will reduce environmental impacts are not unfounded. However, accomplishing time-restrained climate targets without more stringent mandatory actions seems unlikely. The chosen approach lacks positive and proactive investment in social protection. The current inflationary moment was not expected when the plans for the Green Deal were drawn up. By reducing the budget of the Social Climate Fund at a time when it's needed the most, the EU takes another blow at the credibility of the Green Deal.

Many solutions are available that can increase climate ambition and ensure that current targets are achieved. Introducing true pricing and eliminating green premiums would translate into an economical paradigm shift capable of pricing out of the market unsustainable practices and rewarding responsible behaviour. It would represent a whole enforcement of the polluter pays principle and a new era of consumer transparency.

Other measures, such as eliminating subsidies and tax breaks for polluting industries,

especially for energy production, including petrol, and agriculture could gather broader public support if done within a frame of just transition. Increasing the scope of the ETS system and setting a minimum value for carbon prices is in the realm of EU action and should be considered. Further fiscal measures, such as mandatory VAT exemptions and lower taxes for sustainable companies could find resistance from States but should be prioritised to create substantial incentives for change, other than market forces.

Without such measures, after classifying nuclear and natural gas as green investments and reducing social ambition, one begins to wonder how serious the EU really is about the Green Deal.

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