# Ambitious climate action would grow Europe's economy

## Press release

**Investments in line with Europe's expected 2040 climate target would create important economic opportunities across sectors, according to a new report by Agora Energiewende. Building on these findings, the think tank outlines how public funding can help unlock the necessary private investments and overcome the 'climate funding cliff' after the EU's recovery fund ends in 2026.**

**Brussels, 16 September 2024.** The investments needed to cut Europe's greenhouse gas emissions by 90 percent by 2040 would help grow the EU economy by around two percent, a new study by Agora Energiewende finds. Investing in areas such as cleantech, net-zero infrastructure and building renovations would strengthen EU manufacturing, create new jobs and foster economic convergence between Western and Eastern Europe.

In its study entitled "EU climate policy between economic opportunities and fiscal risks", the think tank analysed the macroeconomic impacts of the transition to climate neutrality for the EU as a whole, and for five of its biggest member states: France, Germany, Italy, Poland and Spain. As a result of the investments into climate neutrality, Germany, France, Italy and Spain are expected to see moderate economic growth, while Poland's real gross domestic product (GDP) is projected to increase by around five percent through 2040 compared to baseline levels.

Matthias Buck, Director Europe at Agora Energiewende said:

"The transition to net zero is as much about climate as it is about safeguarding Europe's strategic interests – from competitiveness to security and prosperity. Our analysis shows that the EU can both transform and grow its economy. Ensuring the necessary investments in the Green Deal is key to achieving this."

The report's findings are based on Oxford Economics' modelling of the economic and fiscal implications of Agora Energiewende's EU Gas Exit Pathway, a techno-economic roadmap to the EU's 2050 climate-neutrality goal. The study outlines three different policy scenarios which are compared to a baseline scenario. The positive macroeconomic projections assume that governments promptly address for example the existing financial constraints for households and firms through regulatory and fiscal frameworks.

**More fiscal flexibility is needed to enable public investments**

The economic growth assumed in the study helps to reduce the average public debt ratio in the EU. However, EU fiscal rules that require keeping debt levels on a declining path, will pose a challenge for Italy and Spain. Among the analysed countries, they will need the most significant fiscal consolidation to comply with these rules – even excluding climate spending. The fiscal implications of the energy transition may also force less indebted governments using public deficit limits (such as Germany's *Schuldenbremse*) to undergo fiscal adjustments. Agora Energiewende therefore recommends more flexibility in EU and national fiscal rules so that governments have enough budgetary space to support climate-related investments.

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The study also finds that EU carbon prices will rise significantly in the medium term following the latest reform of the EU emissions trading system (EU ETS), bringing important revenues for governments to invest in the transition. However, these revenues will be offset in the 2030s by the erosion of the fossil fuel tax base, as the consumption of fossil-based products – notably gasoline and diesel for motor vehicles – declines. The study finds that the net amount available to EU governments from carbon pricing, once the tax losses are included, is on average 27.5 billion euros per year in the period 2030-2035. It turns negative after 2037, while EU-wide public spending needs exceed 200 billion euros per year in the 2030s.

Matthias Buck:

"Revenues from carbon pricing will start to decline in the mid-2030s. This underscores the value of EU climate funding in the next multiannual budget. EU co-financing of national climate investments for example in buildings and clean transport reduces the need for governments to choose between fiscal and environmental sustainability."

**Enhancing the impact of EU climate funding**

Implementing the European Green Deal is a core task for the 2024-2029 EU policy cycle and will require significant investments. These investments will mostly come from private sources, but public funding plays a key role in unlocking them. The Agora study calculates that at least 462 billion euros (in 2023 prices) – corresponding to 2.7 percent of the EU-27 GDP – of investments will be needed every year throughout this decade. These investment needs will further increase to 3.3 percent or 564 billion euros (in 2023 prices) in the 2030s before they taper off again. The share of public investments corresponds to around 1.1 percent of EU GDP annually.

Against this backdrop, a separate Agora report, "Investing in the Green Deal", makes proposals on how to enhance the impact and ensure the continuity of EU climate funding. The need to strengthen the impact of EU climate funding is underscored by the recent report of the European Court of Auditors (ECA) on the contribution of the EU's Recovery and Resilience Facility to achieving climate objectives. The ECA found that the climate contribution of several projects funded through the facility may have been inflated.

The Agora report argues that the impact of EU climate funding can be significantly increased through better and more granular information about national climate investment needs. The think tank thus recommends making it mandatory under the energy governance framework for EU countries to carry out national climate investment needs assessments and to develop complementary investment plans. The assessments should follow a common methodology.

"Clear national climate investment plans would improve coordination of EU climate spending across programmes and budget lines and provide scope for consolidating and simplifying the future EU budget. Such plans would also allow for a more meaningful ex-post analysis of the effectiveness of climate investments and ensure that governments use public spending to achieve their climate targets," explained Matthias Buck.

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## Overcoming the climate funding cliff

Several factors, most importantly the end of the NextGenerationEU budget in 2026, will result in a climate funding cliff after 2026. In light of this, Agora proposes measures that would stabilise available EU climate funding before the next multiannual EU budget starts in 2028.

These measures include establishing an off-budget funding mechanism to frontload national revenues from the future carbon market for buildings and transport (ETS2). Such a mechanism could unlock 36 billion euros of investments in the transport and buildings sectors before 2028. The mechanism would issue debt today to finance the disbursement of grants and recoup an agreed amount of national revenues directly from the future auctioning platforms. The advantage of frontloading future national ETS2 revenues via a dedicated EU facility is that the debt issued for this frontloading would
not count as national debt, the authors note.

"The proposed mechanism would enable governments to step up investments in clean heating and mobility well before the start of the new carbon market for transport and buildings. This would help keep prices under the system in check while accelerating investments into clean solutions in these sectors," said Matthias Buck.

Agora also recommends an early replenishment of the InvestEU Fund that was set up to support companies recovering from the economic slowdown caused by the Covid-19 pandemic. The EU budget enabled an initial guarantee of 26.2 billion euros that are estimated to trigger around 372 billion euros in additional investment over the 2021-2027 budget period. The guarantees that underlie InvestEU will be depleted by 2025. EU countries should use available flexibilities for shifting unused funds from other budget lines to the InvestEU Fund. This could provide an additional budget guarantee of around 21.5 billion euros and leverage around 245 billion euros in additional investments. The replenished InvestEU Fund should particularly focus on supporting investments into cleantech manufacturing in Europe.

Commission President-elect Ursula von der Leyen has promised to put forward a "European Competitiveness Fund" during the first 100 days of her second term in office. In this context, Agora proposes establishing a new standalone fund worth 260 billion for the 2028-2034 budget period focusing on the implementation of the Green Deal. The fund should, among other things, provide support for cleantech manufacturing in line with the targets set out in the Net-Zero Industry Act (NZIA) and could be financed through a balanced mix of new own resources such as a methane fee or financial transaction tax.

The 38-page study "EU climate policy between economic opportunities and fiscal risks" and the 49-page impulse paper "Investing in the Green Deal" are available for free download at **www.agora-energiewende.org**.

### About Agora Energiewende:

Agora Energiewende develops scientifically sound and politically feasible concepts for a successful pathway to climate neutrality – in Germany, Europe and internationally. The organisation which is part of the Agora Think Tanks works independently of economic and partisan interests. Its only commitment is to climate action.

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