HSBC Global Research

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EU Green Deal Push(back)

What to watch in 2024 as focus shifts to implementation

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- The EU Green Deal set ambitious climate targets that are now supported by a comprehensive legislative framework
- After a surge of legislative activity in late 2023, most key EU Green Deal legislation is now provisionally agreed or adopted
- As focus shifts to implementation in 2024, carbon pricing, finance and policy co-ordination reform are key to success

The EU established the Green Deal in 2019; its flagship strategy to transition to climate neutrality by 2050. This triggered a wave of EU legislation to align EU law with 2030 and 2050 emissions targets. However, recent signs of EU climate policy wavering and regulatory pushback have left many confused on progress. Investors and corporates often ask us for clarity on this complex and often opaque legislative process. So where is Europe up to? Is there pushback and what comes next?

This note provides clarity on the status of all Green Deal legislation. We assess all 74 pieces of Green Deal legislation (Directives and Regulations). After a surge of legislative activity in the final weeks of 2023, in our view, nearly all policies that are critical to achieving Green Deal objectives (60 of 74) are now provisionally agreed or adopted. We examine the crucial legislative activity over recent weeks, explaining major obstacles and contentions. While some laws were watered down to reach agreement, there is no evidence of a slowdown in EU climate policymaking.

In 2024, attention will need to shift to rapid implementation of Green Deal legislation by Member States; an *assessment* shows that the EU is not on track to achieve its 2030 emissions goals. In our view, there are several issues to watch that will have a significant impact on cost-effective implementation at the macro level and corporate risks and opportunities at the micro level. The outcome of June's European Parliament election could be crucial: a shift to the right could see less urgency on climate action and the key reforms needed for successful implementation in Member States; including expanded carbon pricing, scaling public and private finance and clean investment, and better policy co-ordination.

Investors should, in our view, probe affected sectors and companies to ensure they are properly assessing the risks and opportunities from the implementation of Green Deal laws across EU Member States.

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European Green Deal Push(back)

- Several key Green Dean laws were provisionally agreed in late 2023, completing key parts of the Green Deal legislative agenda
- We explain this key legislation and obstacles that made it contentious and challenging for the Parliament and Council to agree
- We also explain the complex EU legislative process, which will facilitate understanding of this report and the analysis

The EU is almost at the Green Deal legislation finishing line

In our view, the EU has made good progress on the EU Green Deal legislative agenda. There is still more to do, but after a concerted push to agree/adopt key legislation in the final weeks of 2023 most of the key legislation is now complete, including all key parts of the "Fit for 55" package.

Over 80% of Green Deal related legislation has been adopted or is close to adoption

In total we assess that there are 74 pieces[1] of Green Deal related legislation (Directives and Regulations). A total of 60 are already adopted (or have been provisionally agreed by the EU Parliament and EU Council and are in the process of being rubber stamped). These 60 are the crucial Directives and Regulations that will be implemented by Member States and drive investments and actions to reduce emissions and achieve 2030 emissions goals.

This leaves 14 still to be adopted, most of which, in our view, are less crucial to meeting the EU's 2030 emissions targets, but are still important none-the-less..

Figure 1: Status of European Green Deal legislation

Source: HSBC based on European Parliament and European Council

A full list of all 74 pieces of legislation is presented in the full piece, available to clients of HSBC Global Research.

What has happened? We explain key EU Green Deal legislative activity in December 2023

This report examines the key pieces of legislation provisionally agreed, adopted or rejected in the final weeks of 2023 (and also important legislation where agreement could not be reached) (Figure 2). Investors may have missed some of the flurry of legislative activity in recent weeks with the distractions of COP28 and year-end.

[1] In addition to these 74 pieces of legislations, four pieces of legislation were blocked/withdrawn.

Figure 2: Status of key Green Deal legislation reviewed in this note

Key steps in the EU "ordinary" legislative process ➔	**Proposal published** by the European Commission (EC)	**Feedback** on proposal	**Parliament** (EP) adopts **negotiating mandate**	**Council** (EUCO) adopts **negotiating mandate**	**Trilogues** between EP, EC and EUCO	**Provisional** agreement reached	**Adoption** after formal approval within EP and EUCO
Regulation on the sustainable use of plant protection products	Completed	Completed	Completed **	Ongoing	Pending	Pending	Pending
Revision of the EU Gas Regulation	Completed	Completed	Completed	Completed	Completed	Completed	Pending
Revision of the EU Gas Directive	Completed	Completed	Completed	Completed	Completed	Completed	Pending
Revision of EU electricity market design	Completed	Completed	Completed	Completed	Completed	Completed	Pending
Revision of the Energy Performance Building Directive	Completed	Completed	Completed	Completed	Completed	Completed	Pending
Revision of the Ambient Air Quality Directive	Completed	Completed	Completed	Completed	Ongoing	Pending	Pending
Regulation on packaging and packaging waste (PPWR)	Completed	Completed	Completed	Completed	Ongoing	Pending	Pending
Regulation on development of Euro 7 vehicle emission standards	Completed	Completed	Completed	Completed	Completed	Completed	Pending
Revision of the Energy Taxation Directive (ETD)	Proposal (currently at **standstill**) will follow special legislative procedure requiring unanimity in the EU Council alone for adoption						

Completed   Ongoing   Pending

Source: HSBC, European Parliament, European Council

** The Parliament rejected the Commission's proposal (as amended by MEPs) on the sustainable use of plant protection products

The full note contains a section explaining the complex and often opaque EU legislative process and the structure of the EU legislative machine to help readers understand the analysis. There is generally much confusion around how the EU legislative process is structured and works in practice. We provide a simple guide.

Key reforms to ensure cost-effective implementation of Green Deal legislation in Member States

It is important to keep in mind that EU climate action in 2024 will turn to implementation of Green Deal legislation by Member States. A big unknown here is the outcome of June's European Parliament elections (and other national elections in 2024), which could have a major influence on implementation of Green Deal legislation, e.g. a shift to the right could see weaker policy in some Member States (noting that delay is not an option as Regulations are binding on Member States once they are published in the Official Journal of the EU, and Directives normally have to be applied by Member States within two years of publishing in the Official Journal).

Reforms that are key to delivering on Green Deal objectives

In addition to the election outcome, or perhaps irrespective of it, there are some key reforms that investors need to watch that will have a large impact on the cost-effectiveness of Green Deal legislation implementation. These are well rehearsed in the literature.[2] Together these will have a substantial influence on not only macro cost-effectiveness of policy implementation, but also on the assessment of company-level ESG risks and opportunities from the low-carbon transition in Europe. These factors include:

- Need for a rapid expansion of carbon pricing/taxation to cover all EU emissions
- Reform of the EU's complex investment support schemes to scale and unlock clean financing (public and private) and deliver green projects
- Reforms to energy and climate policy governance that would see improved cross-Member State policy co-ordination

At the macro level, poor outcomes on these key reforms will likely see EU Member States fail to achieve the real clean investment they need to cut emissions and achieve the EU's 2030 Green Deal emissions targets. Poor green investment may also hurt Europe's growth objectives. At the micro level, a poor outcome would see opportunities lost for corporates (e.g. investment in material and energy efficiency) and transition and climate risk fundamentally altered (e.g. less resilience to climate impacts, less carbon pricing risk, higher market and technology risk, and so on, as international competitors take a stronger lead in the green race).

2 For example: Global Commission on the Economy and Climate, New Climate Economy, 2014.

Strong action on these three key reforms, in contrast, will help to scale profitable clean investment and boost growth at the macro and micro (company) level, and help to deliver the EU Green Deal objectives. We discuss each of these reforms, in turn.

Carbon pricing

The explicit EU carbon price we see quoted and discussed regularly today is derived from a cap-and-trade scheme that covers around 40% of EU emissions. As the theoretical and empirical economic literature is clear that carbon pricing is the most effective and efficient way to reduce emissions, and the EU has ample experience in effective implementation, carbon pricing needs to be extended across the economy to all relevant sectors. This will complement implementation of Green Deal policies in Member States, ensuring cost-effective emissions reductions and a level playing field for all sectors.[3]

The EU is moving in this direction. From 2027 an EU ETS II will begin that covers upstream fuel suppliers to the building and transport sector. Specifically, if will cover fuel combustion in buildings, road transport and additional sectors (mainly small industry not covered by the existing EU ETS).[4]

Analysis suggests that this will expand explicit carbon pricing to around three-quarters of EU territorial emissions. There are also calls from NGOs for an EU ETS III to cover other sectors, which will achieve carbon pricing across the whole EU economy; the same research suggests all three schemes should ideally integrate by 2040.[5]

Investors should assess the risks and opportunities from expanded carbon pricing coverage of their companies. All companies should be anticipating carbon pricing by at least applying a shadow carbon price to their investment decisions today. This should be guided by the latest estimates of the social cost of carbon.

Investors should also watch for social and political pushback as distributional concerns may arise during implementation (the costs of EU ETS II will fall disproportionately on low-income consumers) that will prevent the EU ETS II price rising high enough to effect meaningful decarbonisation. A price stability mechanism applies that will release allowances if the carbon price rises above EUR45 per tonne over two consecutive months. The EU has also established a Social Climate Fund to alleviate any distributional impacts, financed by EUR65bn from the EU budget 2026-32, plus 25% co-financing by Member States.[6]

Public funding for transition investment and social and distributional issues

The EU funding machine is vast and complex. In terms of the Green Deal, the COVID-19 pandemic saw a proposed EU Green Deal Investment Plan replaced with The EUR723bn Recovery and Resilience Facility (RRF). The green conditions on the RRF included a minimum spend of 37% on climate investments. While most EU Member States submitted plans that met this minimum requirement, few went beyond this, citing a lack of available projects that satisfied key conditions for stimulus investment, including that they must be fast (quick to implement); labour intensive (to soak up the excess supply of labour, particularly in vulnerable and disadvantaged groups and regions); have strong multipliers in the short and long term (each EUR invested needs to maximise the impact on GDP now and drive productivity in the long run), and deliver strong co-benefits in terms of local pollution, health, congestion, efficiency, innovation and resilience in its broadest sense, including adaptation and reducing inequality. This was despite a concerted push by climate advocates that clean investment satisfies these criteria much better than other (often 'brown') investment.[7] In reality, although it is likely that green investments do better on most of these criteria, the one that was lacking was "fast"; Member States lacked the capacity to deliver green projects quickly.

3 *ETS 2: buildings, road transport and additional sectors*
4 *Ibid.*
5 Bruegel. 2023. A new governance framework to safeguard the European Green Deal, Policy Brief, September.
6 *Social Climate Fund*
7 Aldersgate Group. 2020. Rebuilding to Last: How to Design an Inclusive, resilient and sustainable growth strategy after COVID-19.

All EU public funding programmes that will benefit Member State implementation of Green Deal legislation are presented in Table 1.

Table 1: EU climate-related financing mechanisms

Fund	Amount (EUR bn)	Theoretical climate action share	Timeline	Main focus	Beneficiaries
Recovery and Resilience Facility	338 in grants (723 in grants + loans)	37%	2021-26	Implement reforms and investments to deliver the twin transition (digital and green)	All EU countries (but bias in favour of least-developed and most crisis-affected ones)
Innovation Fund	40 (from EU ETS)	100%	2020-30	European industries	All EU industries subjected to the ETS
Modernisation Fund (1 and 2)	20 + 25.8 (from EU ETS)	100%	2021/ 2024-30	Energy systems and energy efficiency	10 least-developed EU countries
Just Transition Fund	20.3	100%	2021-27	To help alleviate the socioeconomic costs of the transition for the most negatively affected regions and people	All EU countries (but biased towards those most affected by closure of coal mines and sectoral transition)
Social Climate Fund	65	100%	2026-32	To cushion citizens and companies from the consequences of extending the ETS system to the building and road transport sectors	All EU countries

Source: Bruegel 2023. A new governance framework to safeguard the European Green Deal, HSBC

As the RRF is due to end in 2026, there is an urgent need to replace this with a new funding mechanism that Member States can access and use to leverage private capital for green projects. Member States are largely responsible for funding for policy, but they will need to access European level funding. It will be important for investors to watch what transpires here. Failure to mobilise adequate capital will slow Green Deal implementation, affecting how risks and opportunities play out for companies.

Total investment levels to achieve Green Deal objectives are very uncertain, but estimates of the additional public and private investment required to achieve the EU's 2030 climate target (55% reduction in GHG emissions 1990-2030) are mostly around 2% of GDP, or EUR350bn per year, with the public investment share roughly EUR80-170bn per year (0.5-1% of GDP). However, the amount of private capital will depend on the mobilisation ratios achievable.[8] This is very uncertain.

One way to mobilise private capital is through state-owned investment banks, e.g. the European Investment Bank (EIB), which is central to delivery of green deal finance. Recent evidence suggests mobilisation rates through development banks has been extremely low, from 0.1 to 1. However, with the use of innovative instruments and structures some banks have achieved a ratio of around 3. The mobilisation required in Europe to achieve Green Deal 2030 targets will need to be at the upper end of these ranges. The EIB indicates in a recent *announcement* that it has committed EUR45bn by 2027 to REPOwerEU and Green Deal objectives and this will mobilise a total of EUR150bn in investment, representing a ratio of just over 3. This ratio is encouraging, but the public finance amount is not even close to the scale needed to deliver on the Green Deal goals. Nevertheless, investors can look out for opportunities to invest directly in clean projects through the EIB, reducing risk and uncertainty.

After the RRF ends, maintaining public investment even at current levels, around EUR50bn per year (approximately 0.3% of EU GDP) and scaling this up to the 0.5-1% of GDP necessary, and also ensuring high mobilisation ratios of over 3, will be very challenging for the EU. To date, there is little clarity on how the EU will replace the RRF and achieve the step up in funding needed. For example, the Net Zero Industry Act sets out a strategy for investment in clean technology manufacturing in the EU, but does not directly provide funding.

8 Bruegel. 2023. A new governance framework to safeguard the European Green Deal, Policy Brief, September.

With no agreement for sovereign borrowing at EU level, discussion has centred around the new Strategic Technologies for Europe Platform (STEPS), continued use of state aid rules to support the objectives of the EU Net Zero Industry Act, and other initiatives to simplify navigation of EU finance mechanisms, e.g. the Net Zero Europe Platform. However, again, these are seen as inadequate in scale and nowhere near what competitor nations are already delivering, e.g. the clear public funding set out in the Inflation Reduction Act (IRA), which is already mobilising significant investment in the US.

Of interest here is a decision in Germany in early January 2024 to use a new "matching scheme" under EU state aid rules. Germany will "match" the funding that battery manufacturer Northvolt would receive under the US Inflation Reduction Act (IRA), keeping investment in the EU. The European Commission approved the deal that will see Northvolt receive a EUR700m grant (funded by German federal and regional governments) and a state guarantee of just over EUR200m, around 20-25% of the total capital costs of the project. Watch for a European Commission update soon on total funding provided across Member States under these state-aid rules.

Policy governance reform

While the EU is responsible for Green Deal legislation, Member States are responsible for implementation. There are several longstanding implementation challenges in Europe. In the period to 2030, one of the key factors that will determine if the EU achieves its emissions target is energy policy governance, which largely involves better policy coordination and coherence.[9] Reform here is needed to ensure the energy transition accelerates.

While there are some EU-level goals, e.g. the renewables, energy efficiency, hydrogen production and electricity interconnection targets, few of these are translated into individual Member State targets. Even then, e.g. the renewable target is translated into Member State targets, the governance arrangements to ensure compliance with the EU targets are weak and need strengthening.

An attempt at strengthening governance involves the European Commission requiring Member States to produce National Energy and Climate Plans (NECPs), which detail policies to meet EU targets. The European Commission assesses these and provides recommendations. But it is unclear how these plans and recommendations can be enforced. To date, compliance has never been tested. Member States are also required to co-ordinate and consult each other when designing their NECPs, however there is little evidence this happens in practice; NECPs appear to have become a box-ticking exercise.

In practice, it is Member State's national governments, their regulators, energy transmission system operators and energy companies that do the actual implementation of policy – the latter does the physical investment. A much better co-ordination mechanism is required to ensure all these key players are joined up both internally and across Member States; co-ordination is currently weak and risks delaying the investment that will drive transition and emissions reductions in this crucial sector.[10]

Investors should monitor and assess any reforms that impact deliver of energy decarbonisation goals, e.g. the recent Hydrogen and Gas Markets Decarbonisation Package that aims to create a market for renewable gases (including hydrogen) in Europe (see above). These assessments will be key for assessing risks and opportunities for energy companies and other companies exposed to the energy sector.

This is a Free to View version of a report with the same title published on 10-Jan-24. The full note contains a simple guide of the EU legislative process and the structure of the EU legislative machine as well as a discussion of the key legislative activity in the final weeks of 2023. Please contact your HSBC representative or email us at AskResearch@hsbc.com for more information

9 *Ibid*.
10 The OECD has done extensive work on policy coordination, which Member States should learn from in the coming period of Green Deal legislation implementation.

Disclosure appendix

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