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Energy Taxonomy Poses Serious Challenges to EU's Economy

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EU Taxonomy for Sustainable Energy Activities

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Introduction

According to European Commission's thinking and in order to meet the EU's climate and energy targets for 2030 and in line with the European Green Deal, it is important to direct investments towards sustainable projects and activities. "The current COVID-19 pandemic has reinforced the need to redirect capital flows towards sustainable projects in order to make our economies, businesses and societies, in particular health systems, more resilient against climate and environmental shocks and risks with clear co-benefits for health", underlines the EC. **(1)**

To achieve this, a common language and a clear definition of what is "sustainable" is needed. This is why EU's action plan on financing sustainable growth called for the creation of a common classification system for sustainable economic activities, otherwise known as "EU taxonomy".

However, as we shall argue further on, EU taxonomy is fast becoming a rather contentious issue as a number of governments are suddenly discovering that their countries are being grossly sidelined when it comes to energy resources and access to "acceptable" technologies and means of production.

What is the EU Taxonomy?

According to the European Commission, the EU taxonomy is a classification system, establishing a list of environmentally sustainable economic activities. The EC believes that its taxonomy is an important enabler to scale up sustainable investment and so implement the European Green Deal. Notably, by providing appropriate definitions to companies, investors and policymakers on which economic activities can be considered environmentally sustainable, it is expected to create security for investors, protect private investors from greenwashing[1], help companies plan the transition,

[1] Greenwashing is considered an unsubstantiated claim to deceive consumers into believing that a company's products are environmentally friendly.

mitigate market fragmentation and eventually help shift investments where they are most needed.

Taxonomy Regulation and Delegated Acts

The Taxonomy Regulation (EU Regulation 2020/852)[2] was published in the Official Journal of the European Union on 22 June 2020 and entered into force on 12 July 2020. It establishes the framework for the EU taxonomy by setting out four overarching conditions that an economic activity has to meet in order to qualify as environmentally sustainable.

The Taxonomy Regulation establishes six environmental objectives:

1. Climate change mitigation
2. Climate change adaptation
3. The sustainable use and protection of water and marine resources
4. The transition to a circular economy
5. Pollution prevention and control
6. The protection and restoration of biodiversity and ecosystems

Different means can be required for an activity to make a substantial contribution to each objective. The Taxonomy Regulation tasks the Commission with establishing the actual list of environmentally sustainable activities by defining technical screening criteria for each environmental objective through delegated acts.

Currently, there appear to be two energy subsectors, namely nuclear power and natural gas, whose status as environmentally sustainable forms of energy remain in doubt and hence classification is at stake.

[2] https://ec.europa.eu/info/law/sustainable-finance-taxonomy-regulation-eu-2020-852_en

Assessment of Nuclear Energy

In 2020, the European Commission launched in-depth investigation to assess whether or not to include nuclear energy in the EU taxonomy of environmentally sustainable activities. As the first step, the Joint Research Centre, the in-house science and knowledge service of the Commission, drafted a technical report on the "do no significant harm" aspects of nuclear energy. This publication is a Science for Policy report by the JRC, which aims to provide evidence-based scientific support to the European policymaking process.

The scientific output expressed does not imply a policy position of the European Commission. This report will now be reviewed by two sets of experts, the Group of Experts on radiation protection and waste management under Article 31 of the Euratom Treaty, as well as the Scientific Committee on Health, Environmental and Emerging Risks on environmental impacts. They are expected to issue their reports within three months. These three reports are considered as vital for the Commission's decision.

According to a leaked document, as cited by Euractiv **(2)**, experts tasked with assessing whether the European Union should label nuclear power as a green investment will say that the fuel qualifies as sustainable.

EU countries are split concerning nuclear. A group of seven EU countries, including France, Hungary and Poland, urged the Commission to support nuclear in policies, including the taxonomy. Other states, including Austria, and some environmental groups, oppose the fuel, pointing to its hazardous waste and the delays and spiralling costs of recent projects.

Assessment of Natural Gas

The European Union plans to label some gas-fired power plants as sustainable investments, after an initial proposal to deny them a green label faced a backlash from a group of 10 EU member states.

The European Commission's new proposal, shared with EU countries on March 20, would class gas-fueled plants that generate power plus heating or cooling as a green investment if strict conditions on emissions are met and they are operating by 2025. EU countries are split between those who say that such a decision would imply greenwashing, and those who see gas as crucial for them to quit more-polluting coal. The Commission looks set to delay its decision, after multiple draft proposals failed to bridge that divide. **(3)**

The EU's aim is to steer more capital into environmentally friendly projects to help it deliver on its plan to rapidly slash the greenhouse gas emissions causing climate change. But the taxonomy has become mired in disputes between EU countries over how to treat investments in natural gas, forcing the Commission to rewrite its original proposal from November. Given EU's so far negative assessment of natural gas and the EIB's binding decision to suspend funding for all gas related projects from 1 January 2021, the question surrounding gas suitability as an environmentally sustained form of energy acquires new importance and its role in minimizing GHG emissions.

Natural gas, a fossil fuel, produces roughly half the carbon dioxide emissions of coal when burned in a power plant and countries, such as Poland, Germany and Greece, plan to use gas to wean themselves off the more polluting fuel. However, gas is not emissions-free and there are growing concerns that leaks of potent planet-warming methane from gas infrastructure could cancel out the benefits of switching to gas from coal.

However, seen in a broader context, the switch from coal to gas for power generation offers the single most important step to halve power generation's emissions and this by itself constitutes a bold move towards GHG emission reduction. This is particularly important for SE Europe, where coal and lignite still have dominant role in power generation and gas appears as the only quick way out to reduce substantially GHG emissions, if we assume that this is the desired, (by the EU), objective.

Strict Conditions

Under the draft plan, gas plants that generate power and also provide heating or cooling can be classed as a green investment if they replace a high-emitting fossil fuel-based facility and result in a cut in greenhouse gas emissions of at least 50% per kWh of energy produced.

The gas plant must be operating by 2025, have the potential to use low-carbon fuels in future (e.g. biomass, geothermal) and emit no more than 270 grams of CO_2 equivalent per kWh of energy. For plants only producing power or those that also provide heating or cooling but do not replace a more polluting plant, the Commission stuck to its plan to restrict the green label to plants with life-cycle emissions below 100g of CO_2 equivalent per kWh, according to the draft document. That means gas-fired power plants operating now would need to add technology to capture their emissions in order to qualify.

Critique on EU Taxonomy

In June 2020, following protracted and tedious inter-institutional negotiations, the European Parliament adopted at second reading the compromise regulation for the establishment of an EU framework (the so-called 'taxonomy') to facilitate sustainable investment.

Years of intensive work and engagement with strategic stakeholders, since the publication of the Action Plan on Financing for Sustainable Growth in March 2018, led to an "ambitious" sustainable finance strategy with one key priority in line with EU solidarity: leave no industry nor Member State behind.

The next step is the development of delegated acts establishing realistic and fair technical screening criteria and thresholds for sustainable economic activities eligible for financial support. The Commission's proposed delegated act for the EU Taxonomy for Sustainable Finance, released in December 2020, fell short of the promised solidarity priority.

Despite official public consultations carried out by the European Commission, the delegated act ignored the priorities of numerous stakeholders, from the aluminium and raw materials industries to the refining and energy sectors and left some member states much frustrated by the Commission's disregard for their right to decide on their energy mix and appropriate technologies to achieve the 2030 climate target.

A leaked revised proposal, available since the second half of March 2021, still fails to meet the industry's needs – although a number of activities are now fully taxonomy eligible. Nevertheless, the Commission's revised draft delegated act is, as it stands, "an ineffective plan for supporting businesses and member states across the Union in their attempt to transition towards sustainability", note Members of the European Parliament. **(4)**

A main criticism levelled against the Commission is that the set benchmarks narrow down the basket of technological climate solutions rather than broadening it. The revised delegated act still does not explicitly include liquid and gaseous transport fuels of non-biological origin and Recycled Carbon Fuels – even though they play a critical role in meeting our climate goals.

This clearly limits the solutions available to reduce CO_2 emissions in, for instance, the transport sector where electrification is not always technologically possible. In practice, this means that we are jeopardising the sector's ability to remain competitive by limiting its access to diversified, affordable and sustainable energy. All low carbon liquid fuels (LCLF), alongside electrification and hydrogen technologies, are crucial in achieving carbon neutrality for all transport modes.

"The European Commission should look to facilitate, rather than hinder, investments for the decarbonisation of European industry", note industry circles. By leveraging on the technological expertise of the EU refining industry, we could step up the ongoing green transformation and foster investments in promising technologies, such as sustainable liquid biofuels and all hydrogen-derived synthetic fuels. Predictably, extensive feedback from member states and stakeholders to the December draft taxonomy criteria and thresholds highlight these concerns, which are still present in the Commission's leaked revision.

Discussion

With the final proposal still pending, the task at hand is to ensure that taxonomy criteria and thresholds are established with foresight and broaden the scope of technological climate solutions.

The EU taxonomy has the potential to be a game-changer, but it must adopt a holistic approach, examining all possible solutions to meet climate objectives, moving beyond a narrow confine with labels such as a "brown list" that appear to dictate what is "good" and "bad" technologies. "We need to ensure that there is a level playing field when comparing various technologies, especially low-carbon technologies for fuels, petrochemical feedstock, and other refinery products. Life-cycle analysis and impact assessments are promising methods to achieve fairness and accuracy, and they need to apply horizontally", note the aforementioned industry sources.

Launching a "Renewable and Low-Carbon Fuel Value Chain Alliance", mentioned by the Commission in its December 2020 Sustainable and Smart Mobility Strategy, would be a pragmatic starting point for a broad reflection on these issues with stakeholders involved in aviation, refining, marine, and road transport.

With the right mix of enabling sustainable finance conditions, the EU needs to send clear, long-term signals to guide businesses and investors towards sustainable growth. But for this to be efficient, the full engagement of all actors, from EU institutions and civil society to industry, is absolutely necessary. Only then a realistic and fair EU Taxonomy that can drive the EU towards an affordable and pragmatic transition – and leaves no one behind can be achieved.

But there is a much broader critique at play and this has to do with EC's increasingly assertive role when it comes to a micromanagement and long term planning and the urge by EU bureaucrats to control everything that moves. In this sense, there is growing criticism by several economists who argue that EU's obsession with an ever-expanding list of prohibited activities for the shake of climate change policies and precise guidance on doing things in core power generation activities, is reminiscent of Soviet era type central planning.

Hence, EC's ill-fitting argument that in order to achieve lower emissions and adopt clean technologies towards sustainable energy we need to strictly control the majority of economic activity reveals a streak of a totalitarian mentality rather than a characteristic of a liberal economy, which European leaders like so much to claim as a major EU achievement!

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