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EUROPE'S GREEN DEAL NEEDS TO EFFECTIVELY HANDLE RISING DISTRIBUTIONAL EFFECTS

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Today's political willingness to achieve more ambitious GHG emissions reduction targets by 2030, through legislative tools and financial instruments requires a regulatory breakthrough. **We need a regulatory paradigm shift** to manage the speed of the decarbonisation efforts and the unintended consequences of an aggressive energy transition for citizens and the economy as a whole.

The European Green Deal is a great opportunity to reframe the conceptual framework, the organisational set-up and the regulatory instruments which are necessary to **deal effectively with distributional effects** of energy and climate policies in the short and long run.

This CERRE issue paper gathers four challenges and four recommendations for action to support European leaders in taking effective and **fair measures** to the urgent climate crisis.

4 CHALLENGES

From the conceptual framework to adequate instruments

1. Current energy and climate policies have had direct and indirect distributional effects, but research has so far failed to quantify the issue.

Today's *ex-ante* research is not sufficient for policy-makers to understand the impact of future policy options, such as carbon taxes on particular sectors, the introduction of incentives to acquire electric cars, the phase-out of diesel cars in urban areas, the increase in the CO_2 price and its impact on the industrial base, the extension of the ETS scope to the transport and/or building sectors, the implementation of efficiency standards for consumer goods, and tax rebates to facilitate access to home solar panels.

In other words, there is a clear **lack of scientific evidence** concerning how, for instance, a new carbon tax on aviation or new taxation for fuels could eventually impact different segments of society.

2. Defining clear regulatory and policy instruments to handle the distributional impacts of climate policies is critical.

There is a lack of clear categories of regulatory and policy instruments that may **genuinely anticipate and actually alleviate** the excessive or undesired distributional impact of climate change policies on specific communities or consumer profiles. The scope and main target of regulation is a critical element to be considered when new regulation and policy is designed.

3. Information, data and education about the impacts of climate policies in citizens' everyday lives are key.

Citizens face difficulties in choosing, and being rewarded, when making decisions about the way they consume, travel and invest. The individual **carbon footprint should become a fundamental personal metric** to understand the best rational option taking into account both climate impacts and individuals' budget criteria.

4. What is a distributional effect? How can we measure the implications and side effects from households to large and heterogeneous communities?

Policy-makers may assume that distributional effects are a trendy way to rebrand the well-known concept of *energy poverty*. According to the definition of the EU Energy Poverty Observatory (EPOV): "*Energy poverty occurs when a household suffers from a lack of adequate energy services in the home*"[1]. The definition of energy poverty is traditionally confined to the access of low-income households to a basic societal need: regular and sustainable electricity supplies[2].

Policies and measures take one of two approaches: either easing higher electricity bills or promoting energy efficiency technologies/gadgets to boost savings. While the economic theory is mainly focused on households and the impacts on particular income categories (low, medium and high), the **distributional effects of complex climate policies require more sophisticated analysis**.

The impact of policies will become ever more aggregated, granular, geographical and unexpected. The impacts will be felt across low and medium, or medium and high, income communities as a whole, rather than individual households with a particular economic profile. Our **analysis must shift** from the individual consumers' profile to new categories that can capture the different types of impacts.

While being appropriate to continue to deal with energy poverty, this conceptual framework is leading to a severe **misunderstanding of the gravity** and complexity of the distributional effects at stake. It also discourages the real need to redesign policy and regulatory instruments to either prevent or mitigate the side effects of intrusive climate policies. Three types of effects are described below:

Sudden loss in income effect impacting a large community

This is the most **aggressive and structural effect.** An example of this is the halt to the use of coal and mining activities in the EU. A critical decision to accelerate the decarbonisation of the economy.

This is about more than just distributing income. In principle, coalmines will never operate again and that particular source of income will disappear forever from nations' GDP and communities' pockets.

This sudden loss in income for entire regions is a gigantic challenge that **deserves structural financial support** for a fair and smooth transition, such as the *Coal Regions in Transition* programme sponsored by the European Commission.[3]

Other examples include the decommissioning of stranded assets or critical energy infrastructure, prohibition of diesel or petrol cars and phasing out of energy sources.

Major effects on local communities with specific demographic and socio-economic features

A carbon fuel tax is an example of such distributional effects.

In France, this policy unintentionally triggered the national movement known as the "yellow vests". It has created a **heavy cost for a specific socio-economic community** across the country, which perceived this decision as a major burden for their relatively limited income. They consider this an unfair distributional measure that forces them to finance climate policies.

This particular case also revealed the dramatic gap between the *sensitivity of the policy* that the government enacted, the *societal perception* and the *real impact on a heterogeneous socio-demographic group*.

Distributional effects on consumer groups with specific socio-economic profiles

This category reflects the distributional effects for particular consumers associated with certain policies and standards which are designed to encourage the acquisition of low carbon technologies or services.

Most often these aim at improving energy efficiency (i.e. house insulation) or obtaining benefits or discounts to enable access to certain services.

This notion is closest to the traditional concept of **'energy poverty'**.

[1] See more at https://www.energypoverty.eu/
[2] See initiatives in the EPOV website such as the "Disconnection Prohibition" during winter periods for particular households. More examples here: https://www.energypoverty.eu/measure-policy/disconnection-protection-catalonia or https://www.energypoverty.eu/measure-policy/disconnection-prohibition-winter
[3] See more at https://ec.europa.eu/energy/en/topics/oil-gas-and-coal/EU-coal-regions/coal-regions-transition

4 RECOMMENDATIONS FOR ACTION

The European Union can and must act to overcome these challenges

1. Launch a new European Observatory for Distributional Effects of the Energy Transition (ODET).

The body's mission[4] should be to promote new research on the existing legal framework and to systematically **monitor and collect best practices** across the continent. One particular function of the ODET should be to develop a new tool in which European Sensitivity Areas for Distributional Effects are defined and updated over time. This screening exercise of specific geographical zones should include different types of socio-demographic groups based on a particular income situation.

2. Add distributional effects as a fundamental criterion for all new legislation that implies energy, mobility and climate action measures.

All European Commission **impact assessments should integrate distributional effects analysis** and testing as a pre-condition for the publication of any new legislative proposal. This principle could be expanded to other policy areas, but a first phase test with forthcoming policies such as the 2020 decarbonisation Package, the alternative fuels infrastructure Directive revision, the extension of the scope of the ETS and the carbon adjustment border tax could help to build up some experience and tackle practicalities to assess scenarios that would likely have high distributional effects.

3. Better define a regulatory toolbox with options to prevent and/or mitigate the impacts of particular distributional effects.

This toolbox should contain a wide range of options that will always **aim at preventing the worst distributional effects** or supporting the communities in line with the **subsidiarity principle**. The best solutions for distributional effects should start at the local level and move upwards to supranational levels, rather than vice versa.

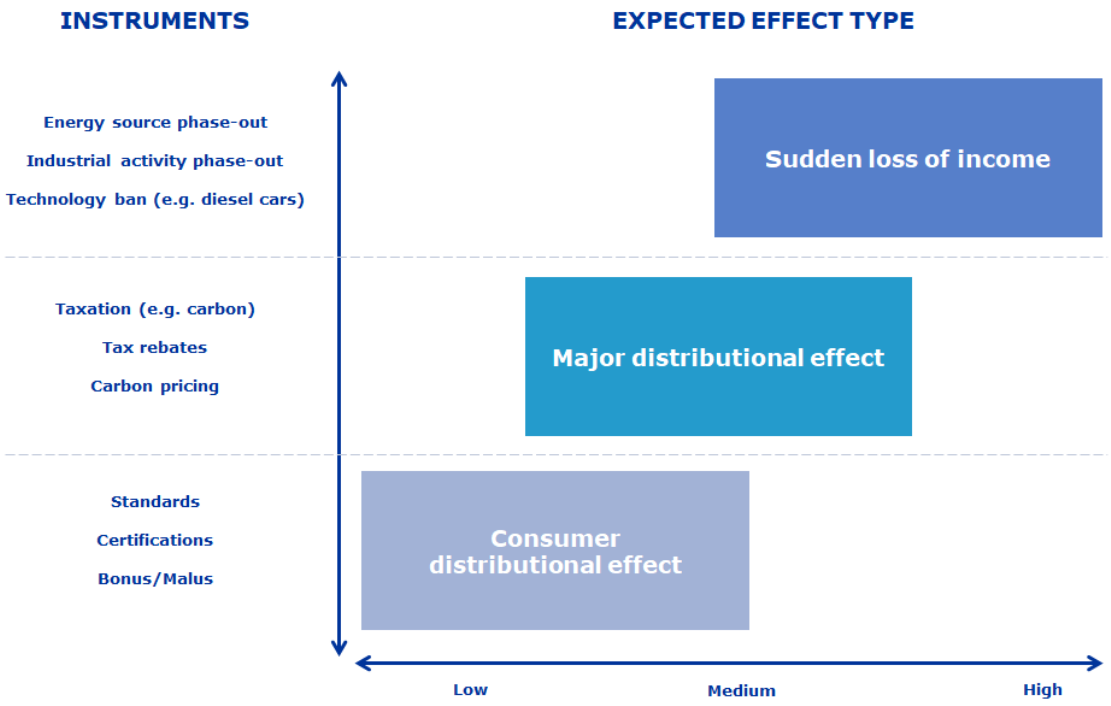
Options to prevent or mitigate the impacts could include regulatory opt-outs, safeguards, sunset clauses, or social exemptions for particular effects or areas. The creation of the *Just Transition Fund* should be framed and allocated within concrete regulatory proposals or, by default, targeted to alleviate primarily policies that would create a sudden loss of income. A cross-sectoral fund for massive social transfers will require scrutiny and clear direction to avoid the abuse or misuse of funds.

4. Connect types of policies/regulation/non-regulatory instruments with expected outcomes on the distributional effects side.

An example of that is the **Distributional Effect Matrix** proposed below. Some regulatory and non-regulatory instruments will have higher or lower societal sensitivities that must be considered.

[4] CERRE Ambitions for Europe 2024 proposed the creation of such an observatory. Read more here: https://www.cerre.eu/sites/cerre/files/cerre_whitepaper2024_energy.pdf

Distributional Effect Matrix



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