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Fiscal Policies to Counter Climate Change and Economic Depression in the Post Covid-19 European Union¹

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Abstract

The Covid-19 health crisis will eventually fade out, but the consequential economic crisis is right ahead of us, along with the ongoing climate crisis. The European Union's policies and institutions seem to hinder the green transition, in favor of fiscal balance and debt repayment among its member states. This paper proposes some fiscal policies, such as an EU "Employer of Last Resort" (ELR) program, which could successfully counter the upcoming depression and climate change, to finally bring economic and social prosperity to the EU's citizens.

Keywords: Climate change; fiscal policies; Employer of last resort; European Union.

Introduction

The world will inevitably face a huge challenge dealing with the Covid-19 economic crisis that is a consequence of the pandemic. Although many pharmaceutical companies are announcing the long-awaited vaccines that will put an end to the pandemic, the economic and social consequences of the Covid-19 induced crisis are yet unknown. The IMF projects, regarding the Eurozone's General Government Fiscal Balance for 2020, a disheartening -10.1% of its GDP (IMF, 2020: 6).

Long before Covid-19 emerged, global leaders had pledged in the Paris Agreement to act against an even bigger and more devastating threat: *Climate Change*. As Bill Gates warned in a recent online interview at Trevor Noah's *The Daily Show*: "Once climate change comes, you can't get out of it. There is not a vaccine for that" (Gates, 2020). According to the Universal Ecological Fund, 9% of the global GHG³ emissions are produced in the European Union's member states (Watson et al, 2019: 1).

This policy brief aims to bring back up the importance of dealing immediately with climate change and the economic recession that lingers on. In the first section, there is an analysis of the opportunities

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³ Greenhouse Gas. The main human-induced productions of greenhouse gases are Carbon Dioxide (CO₂), Methane (CH₄), Nitrous Oxide (N₂O), and Ozone (O₃).

and positive outcomes that the pandemic brought. In the second section, the author mentions the potential economic threats that the structure of the EU and its institutions may create. In the third section, there is a summary of the long-run priorities and regulations that the European Commission has bound to propose by the end of 2024. The fourth and final section, includes the fiscal policies within the framework of EU becoming an “Employer of last resort” and structural changes, for the European Union to effectively reduce its GHG emissions and restore the economic and social needs of its citizens.

Opportunities

According to the American Association for the Advancement of Science, if we wait to respond to climate change and reduce GHG emissions, the effects of climate change will be highly unpredictable and potentially irreversible (Molina et al, 2014: 19). The Covid-19 crisis had a huge impact on the global CO₂ emissions, recording an all-time high reduction of 8.8% in the first half of 2020 compared to 2019, as a result of the lockdowns across the world (Liu et al, 2020: 1). This extraordinary result came along with an unprecedented rise of the General Governments’ debts worldwide, from 83% in 2019 to 98.7% in 2020 (IMF, 2020: 9). The IMF projections of the rising debts imply that we need to find more sustainable ways of reducing GHG emissions, but they also imply that we *can* reduce them substantially, through decisive government intervention, if the majority of the people support these interventions (Hepburn et al, 2020: 4).

Furthermore, a lot of firms and enterprises were forced by their government to change their work environments, as a result of the pandemic. Digital and remote working practice have become an essential part of work-life in 2020 (Hepburn et al, 2020: 15). As long as the employees have the ability and willingness to do so, this could become a new norm and a behavioral shift could be supported by governmental policies that are directed towards digitalization and eco-friendliness. The main reasoning behind this idea is that it motivates the private sector to innovate in digital technologies and, simultaneously, it decreases the use of automobiles. As a consequence, it reduces CO₂ emissions from citizens who drive daily to go to their workplaces.

Another impact of the Covid-19 was the rise of unemployment. According to Eurostat’s “news release euro indicators” that was released on October 1st, 2020, the unemployment rate in the EU has risen to 7.5% and in the Eurozone to 8.1% (Eurostat, 2020). If the unemployment rate doesn’t fall after the pandemic is over, this workforce could be re-trained and employed by the governments, as a new workforce for the green transition from fossil fuels to renewable energy.

Threats

The European Union and Eurozone member states have a more difficult time than other countries in addressing the Covid-19 induced economic outcomes, mainly due to the Maastricht treaty and its criteria⁴. The debt to GDP ratio in the Eurozone countries will rise from 84% in 2019 to 101.1% in 2020, based on the IMF projections (IMF, 2020: 9). Valdis Dombrovskis, the Executive Vice President of the European Commission, in a recent press conference⁵, reminded us that the fiscal measures to counter the pandemic will have to be rebalanced: “All of us will have to endure a new period of restrictive measures” (Dombrovskis, 2020). This statement implies that new austerity will be forced upon member states to restore their balance sheets when the pandemic is over.

Austerity policies in depressed economies cannot produce a sustainable long-term fiscal balance and can be counterproductive. On the contrary, fiscal stimulus during an economic crisis can improve the long-run fiscal balance (DeLong et al, 2012: 234). In addition, many economists and global institutions have argued that fiscal stimulus, as a form of public investment during a recession, tends to have a higher multiplier than in normal phases of the economy (DeLong et al, 2012: 234, Hepburn et al, 2020: 8, IMF, 2020: 40).

These economic policies could pose a crucial threat against the green transition if we keep in mind that the governments have to spend a big part of their budgets towards green investments to effectively address climate change, which will probably not produce any economic surpluses in the short-run. In a study by Miklos Antal, two correlations were analyzed: the first between economic growth and environmental impacts and the second between economic growth and unemployment. He has concluded, that without systemic changes, the green transition with simultaneous full employment cannot be reached (Antal, 2014: 284).

Regulations

European institutions have agreed on a longterm budget plan for the upcoming years (2021-2027) and have dedicated 30% of this budget to fight climate change (EC 2020). According to the EC, this will be “the largest stimulus package ever financed through the EU budget”, which sums up to 1.8 trillion Euros. In order to finance this huge budget, the EC has bound to propose new sources of revenue by June 2024, such as a Financial Transaction Tax (FTT) and a new Common Corporate Tax Base (CCTB) (European Commission, 2020). These regulations, and especially the FTT, have been

⁴ Two of those criteria include that every member state must not exceed public deficits of more than 3% and the debt to GDP ratio should not be more than 60%.

going on in the public and political debate in the EU since the financial crisis that hit the region in 2010.

The FTT regulation was brought to the table in January 2013 when more than half of the Eurozone countries came up with a proposal of a financial transaction tax, so the financial sector pays its fair share of the crisis (Kastner, 2018: 1648). After a year of long debates and a lot of compromises and changes to the original proposal, the FTT regulation has been put on hold permanently. According to Kastner, this reform was blocked by the financial institutions with heavy use of lobbying and carefully waiting until the storm of the financial crisis has passed, before arguing about the scientific evidence against it (Kastner, 2018: 1661). It remains to be seen if the same forces will block the new attempt of bringing the FTT regulation back on the table. The main difference between then and now is that the climate crisis will not fade out as the financial crisis eventually did.

On the bright side, regulations regarding the reduction of GHG emissions have been successfully adopted in the EU. Following the Paris Agreement, the EU in 2018 has inserted policies and measures, that are expected to reduce GHG emissions in its member states by 58% in 2030 in comparison to 1990 (Watson et al, 2019: 9). Although the EU is on track to reducing its GHG emissions, these policies have not addressed the unemployment that the new production model shift will create.

Fiscal Policies - Conclusions

It should be obvious by now, that in order to counter climate change and restore economic and social prosperity, the EU has to propose some fiscal policies that are unconventional within its framework and structure. The climate crisis needs fiscal policies to counter it, just like the Covid-19 crisis needed, but for a longer period. The private sector by itself is not likely to give up fossil fuel dependency, not at least until the costs of clean energy are low enough and the macroeconomy is stabilized (Hepburn et al, 2020:4). Thus, fiscal policies and regulations by the authorities must be injected for a sustainable socioeconomic recovery and green transition.

The main fiscal policy that the EU could use is Minsky's Employer of Last Resort (ELR) program. Hyman Minsky was not supporting "one size fits all" policies and believed that policies must be coordinated with the institutional and structural changes during their adaptation (Wray, 2007: 3). In the EU, the member states have different needs and fiscal space, so policy-makers have to identify potential co-benefits during the policy design stage and shape implementation criteria to maximize their impact. As priorities between the member states and social needs can differ substantially, the prioritization of relevant co-benefits is likely to also differ (Hepburn et al, 2020: 13). From this

perspective, the fiscal policies should differ between the member states and cannot be implemented under the EU's current framework.

Minsky argued that only the governments can offer unlimited jobs to those who are unemployed at the going wage, for either skilled or unskilled labor, depending on the applicant's particular skillset. This program could eliminate unemployment, reduce poverty, boost effective demand, and set an effective minimum wage (Levrero, 2019: 44). Although Minsky's ELR job proposals were different than those in the context of climate change, the main notion for the ELR to be successful is the same: the ELR program should provide visible public benefits for all the taxpayers (Wray 2007: 14).

The ELR program for countering climate change and unemployment could include public investments in (Hepburn et al, 2020: 13):

- Clean physical infrastructure investment in the form of renewable energy assets, storage (including hydrogen) and grid modernization
- Renovations and retrofits such as improved insulation, heating, and domestic energy storage systems
- Educational and training programs to address unemployment from COVID-19 and structural shifts from de-carbonization
- Sustainable agriculture, ecosystem regeneration and accelerating clean energy installations

There are many difficulties in implementing an ELR program in EU countries. The main reason is the European Central Bank's (ECB) structure that limits the ability of Eurozone countries to finance public deficits, which are crucial for an ELR program (Levrero, 2019: 53). The EU financed the member states public deficits to counter the pandemic as there was no other alternative for the member states to contain the economic outcomes of the pandemic. The same economic solution could be adopted to counter climate change and the upcoming depression, accompanied by regulations that will provide new sources of income, such as the FTT and the CCTB which have been announced. Structural reforms, based upon the current needs of the citizens, in the EU's institutions must be discussed, as the restrictive fiscal framework is not harmonized with the economic and social problems of the EU's member states regarding public investments. If the EU breaks out of its conventional economic policies, the green transition can be rapid while socioeconomical stability and prosperity can be achieved.

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