THE EUROPEAN GREEN DEAL AND BETTER REGULATION

HIGHLIGHTS NOTE 13

The European Green Deal is the most ambitious policy programme of the European Union in a generation. It seeks to achieve a carbon-neutral, toxic-free economy over a relatively short time span. Nearly every sector of the economy is concerned and called upon to contribute.

This commentary by the ERF addresses some of the most important assumptions of the Green Deal. It argues that, to deliver for citizens, both the design and implementation of the Green Deal are critical. For these reasons, Better Regulation must feature at the centre of the programme.

THE EUROPEAN GREEN DEAL

Europe has embarked on a journey, heading towards a "greener", more prosperous, more sustainable and more inclusive future. The European Green Deal, focused on these objectives, seeks to deliver nothing less than a social and economic revolution. It is a new strategy for growth.

Specific objectives of the Green Deal include achieving zero net carbon emissions by 2050; decoupling economic growth from resource use; protecting, conserving, and enhancing the EU's natural capital; and, protecting the health and well-being of citizens from environment-related risks and impacts.

These goals have shaped a series of 'flanking' policies that focus on specific areas where radical change is needed. The most important include:

- Transforming economic activity through the EU Climate Law and other policies designed to reduce carbon emissions;
- Pursuing sustainable economic growth through the development of a circular economy;
- Promoting resource efficient building and construction;
- Shifting to sustainable mobility;
- Seeking a "Toxic Free Environment", through the Chemicals Strategy for Sustainability;
- Delivering sustainable food production, resulting from the Farm to Fork Strategy:
- Preserving biodiversity;
- Promoting Green Finance; and,
- Investing in research and development.

The EU's policy-makers recognise that achieving these goals will require a shift in the way that Europe produces, consumes, and redistributes wealth. Overall, the Green Deal implies that there will be two distinct, and separate, groups of decisions: on the one hand, discontinuing the status quo (i.e. reducing or even abandoning the usage of current technologies and production systems), whilst, at the same time, proactively embracing new technologies, business models, and modes of production. However, the two types of decision are not necessarily related, nor can they be assumed to occur automatically.

Indeed, delivering successful outcomes will require massive public and private sector investment in innovation, new technologies, new infrastructure, new business models, new products and services, as well as a restructuring of global capital markets to promote greater allocation of capital to 'green' investment and the emergence of breakthrough technologies, ideally through a renaissance in entrepreneurship in the EU.

Moving from policy objectives to effective law-making and implementation is a critical pre-condition for achieving the goals of the European Green Deal. More than ever the extensive and systematic application of good regulatory practices will be needed when designing the laws, regulations, and guidance that will give shape to the European Green Deal. Better Regulation must be the defining concept of the EU decision-making process, if integration and high quality, evidence-based, interventions are to be achieved.

Rue de la Loi 227, B – 1040 Brussels, Belgium
Tel + 32 2 613 28 28 | Fax + 32 2 613 28 29
www.riskforum.eu | info@riskforum.eu

BETTER REGULATION – A CRITICAL GOVERNANCE CONCEPT

Throughout the OECD area, Better Regulation has become an important philosophy of governance. It seeks to strengthen consent to law-making and to the actions of the State needed to implement legal requirements. The EU is a world-leader in the application of Better Regulation principles and tools. As such, it is ideally placed to use this expertise to help deliver the goals of the Green Deal whilst avoiding negative unintended consequences and sustaining the support of citizens.

Better Regulation programmes seek to ensure that laws, and the actions taken to implement them, are *(1) necessary, effective, and proportionate; (2) based on credible evidence, particularly science, that supports the use of the powers of the State; (3) informed by a transparent understanding of costs and benefits, particularly dynamic impacts, such as risk-risk; (4) demonstrate that benefits justify costs; (5) developed using transparent decision-making processes; and, (6) reviewable over time and subject to appeals and redress mechanisms.* Tools such as stakeholder consultation, impact assessment, standards of scientific integrity, and ex post evaluation, supported by institutionalised oversight, political commitments, and laws of administrative procedure, are among the means by which the goals of Better Regulation are delivered.

Used well, Better Regulation provides a way of thinking about making and implementing law that helps governments ensure predictability, avoid regulatory failure, and sustain legitimacy. It is at its most relevant for good governance when governments set out to deliver complex and radical policies that require extensive legal and regulatory decision-making, such as the European Green Deal.

In part, the European Commission's Green Deal Communication of 2020 recognises this. Better Regulation, the Communication explains, will be important for integrating policies, ensuring efficient policy choices, and making sure that individual measures are least burdensome.

However, the importance of Better Regulation for the effective delivery of the goals of the Green Deal is greater than this. It is a critical means of sustaining consent: a necessary pre-condition for policies that pursue widespread radical economic and social change. Alongside this, Better Regulation provides a set of tools and a conceptual approach that helps policy-makers overcome many of the challenges of policy and legislative design, and implementation, that are embedded within the Green Deal.

REGULATORY CHALLENGES

Research by the European Risk Forum (ERF) has identified a series of regulatory challenges that will need to be addressed if the Green Deal is to achieve its objectives. Application of Better Regulation concepts, principles, and tools can help Europe's policy-makers overcome these challenges. They include:

- **Trade-offs and design of policies and legislation** – the sheer scale and ambition of the Green Deal requires the EU institutions to strengthen their Better Regulation capacity, so as explicitly recognise and address policy and legislative tradeoffs (and maximise synergies). Availability of critical raw materials, as well as chemical and metallic technologies will, for example, play a critical role in achieving mobility and renewable energy goals. Similarly, there will be a need to resolve the tensions between the circularity of economic activity and restrictions of materials in waste streams, or again between protection of nature and ambitions to reshape the range of technologies used in the agro-food sector.

- **Coherence in implementation** – recent work by the ERF (notably, the *ERF Monograph 'Risk Management and the EU's Administrative State – Implementing Law through Science, Regulation, and Guidance' 2019*) highlighted the governance weaknesses of the EU's Administrative State: one of the most important mechanisms by which the Green Deal's new laws will be implemented at EU-level. Far greater use of Better Regulation principles and tools is needed in the implementation phase of the policy cycle to ensure that individual actions, such as restricting the use of specific technologies, are coherent with wider policies and that new concepts for determining the use of existing technologies are employed without amplifying unpredictability.

- **Development and application of new technologies** – it is a foundational assumption of the Green Deal that new, breakthrough technologies will emerge, in response to the EU's policies, thereby facilitating economic and social transformation. Such an assumption is promising but needs to be grounded in evidence. Above all, the framework conditions must be created and maintained for it to materialise.

Experience across OECD countries suggests that priority should be given to good regulatory principles (most notably technology neutrality) and practices, such as economic incentives rather than command-and-control rules. Regulatory standards should be based on performance rather than design. Safety rules are better focused on applications rather than technologies. And, in overall terms, the regulatory framework should maximise the opportunity for investors and entrepreneurs to compete. Where necessary incremental change should be supported. The European economy and industrial base have an impressive track record and still possess a remarkable potential for incremental innovation. These ideas should be explicitly embedded in the EU Better Regulation framework.

- **Allocation of capital** – EU policy-makers accept that delivering the Green Deal will depend upon a major allocation of capital by the private sector. For this to happen, there must be a large number of ‘positive’ decisions by the private sector to allocate capital in a Green Deal Europe rather than in pursuit of opportunities elsewhere. It is, therefore, essential that EU regulators recognise the basis on which capital is allocated by private sector enterprises.

Corporate finance principles and practices, employed by most major companies, distinguish rigorously between financing decisions (concerning issues such as gearing, solvency, liquidity, and cash servicing costs), and *investment decisions*. It is this latter type of decision that determines whether to allocate capital, based on projects achieving the after-tax risk-adjusted cost of capital. This requirement is set by global capital markets and is not, in general, affected by the way in which companies are funded or by the social priorities of governments. Better Regulation tools provide a means of assessing policy and legislative design to ensure that capital allocation decision-making processes are recognised explicitly, such that the EU becomes an attractive location for investment.

- **Investment in innovation** – delivering the Green Deal will require significant investment in innovation. This is widely accepted. A challenge facing regulators is to ensure that the regulatory framework maximises incentives to invest and minimises obstacles. Again, it must favour ‘positive’ rather than ‘negative’ decisions. Work by the ERF (notably the *ERF Monograph ‘Fostering Innovation – Better Management of Risk’ 2015*) has identified existing regulatory obstacles to innovation, including high levels of defensive R&D, extended time-to-market, loss of access to key materials and technologies, unpredictable risk management, market stigmatisation, and a lack of policy coherence. Better Regulation principles and tools provide a means of assessing Green Deal policies and proposed measures to ensure that these problems are recognised and considered explicitly.

- **Investment in operating efficiency** – one of the aims of the Green Deal is to transform the economy of the EU by ‘greening’ production technologies, requiring the use of sustainable inputs, and stimulating the substitution of existing products for new safer and greener ones. Whilst they may create opportunities, these aims potentially pose a major problem for the operating efficiency of businesses, because of higher input costs, increased operating costs, reduced contribution margins (from expected restrictions on the use of product technologies due to ‘essentiality’ tests, for example), and lower income from waste.

Taken together these impacts, combined with the costs of replacement investment, may make reinvestment difficult to justify to investors. Measures will need to recognise these challenges and find ways to ease the transition from existing to new production technologies, without disinvestment or delocalisation. Better Regulation provides a governance mechanism to support this.

- **Adjustment costs** – policies designed to promote radical economic and social change will entail disruption: some activities will cease and other will emerge. Often this will occur in areas that suffer from a lack of economic dynamism. Part of the Green Deal recognises this, and foresees supporting funding through the “Just Transition Mechanism”. Better Regulation good practices, particularly the emerging understanding of adjustment costs (such as the erosion of human capital) and health-health impacts (whereby loss of income leads to risky personal behaviours), can complement this, enabling regulators to make informed judgements about the nature and timing of proposed measures.

- **Distributional impacts** – one of the important aspects of the Green Deal is that it will require a major change in behaviours by most of Europe’s citizens. This will include consumption of energy, as well as employment and mobility. Yet the relative consequences of such behavioural changes may vary between different social groups. It should not be overlooked that poorer and less mobile citizens may disproportionately bear such negative impacts. This may erode acceptance of the Green Deal amongst wide parts of society. Understanding, identifying, recognising, and explicitly ameliorating these distributional impacts will be critical for the design of measures that avoid regulatory failure and ensure continuance of consent. Better Regulation provides the governance framework for ensuring that these evaluations take place.

- **Risk-risk tradeoffs** – extensive experience throughout the OECD area suggests that when regulators promote behavioural change, expand the scope of risk management, or change the application of existing rules, then risk-risk tradeoffs may emerge. Whilst ancillary co-benefits may materialise, net risks may be increased rather than reduced as an unintended consequence of regulation. Policies designed to restrict the use of certain mobility technologies may, for example, increase environmental damage when all aspects of usage and production are considered. Similarly, regulatory actions to limit usage of certain chemical or metallic technologies may trigger substitution with less well-understood alternatives or a loss of important benefits.

Such changes are an integral part of the Green Deal and should be fully recognised. Better Regulation tools, when used in line with OECD recommendations, are a critical means of identifying these dynamic impacts, and hence avoiding regulatory failure.

- **Human consequences** – one of the most important, and mostly overlooked, aspects of Better Regulation policies and practices is that they highlight the human consequences of policy, legal, and regulatory decisions. They remind regulators that government actions have consequences for the lives, livelihoods, aspirations, health, and well-being of citizens. This is one of their greatest strengths. Better Regulation policies and tools help, therefore, to bolster legitimacy of measures and consent. Maintenance of consent is a critical requirement if the EU’s Green Deal is to achieve its ambitious goals.

ERF OBSERVATIONS

Extensive use of the principles and tools of Better Regulation can help the EU deliver the aims of the European Green Deal. To build on its existing Better Regulation strategy and guidelines and to help tackle some of the challenges identified in this Highlights Note, the ERF has identified a few but fundamental additional reforms. Specifically:

- **Commitment to applying Better Regulation Principles and Tools** – the EU institutions should formally reaffirm the centrality of Better Regulation as the core foundation of decision-making. Good regulatory practices should be upgraded conceptually and methodologically and applied systematically at all stages of the Green Deal policy cycle:

  (1) During the *'upstream' phase* (policy development), particular attention should be paid to ensuring coherence technological neutrality, and risk-based approaches, and to assessing feasibility, allocation of capital, risks of disinvestment or delocalisation, obstacles to investment in innovation or operating efficiency, and trade-offs.

  (2) When developing *legislative measures*, good regulatory practices, such as impact assessment, public consultation, and ex post evaluation should be strengthened by a greater focus on defining the intervention logic, identifying and assessing dynamic impacts along and across value chains (including risk-risk tradeoffs, adjustment costs, and distributional impacts), as well as ensuring scientific integrity.

  (3) Finally, when *implementing legislative measures*, Better Regulation requirements should be applied to all forms of implementation mechanisms, including regulation (through comitology), substantive guidance, and standards. Particular attention should be paid to coherence with other policy objectives, dynamic impacts, scientific evidence, administrative appeals, and risk-risk.

- **Innovation Principle** – requirements to apply this to all proposed policy, legislative and implementing measures should be strengthened, and new guidance drawn up to ensure that it is used to highlight incentives and obstacles to invest in innovation;

- **New Technologies** – a formal policy should be established for the regulation of new technologies. This should be based on global best practices and should reflect the ideas set out in this Highlights Note;

- **EU Administrative State** – a programme of reform should be established to improve the governance of the EU Administrative State. This should include a political commitment to greater use of proportionality at all stages of the policy cycle; adoption of a comprehensive law of administrative procedures; establishing common decision-making processes and standards for risk assessment agencies based on established principles of good governance; strengthening oversight of the integrity of scientific evidence; putting in place mandatory standards for scientific evidence; more rigorous use of Better Regulation tools to assess implementing measures, including substantive guidance; and, requiring greater use of cost-effectiveness analysis.

- **Better Regulation Guidelines** – the requirements and methodological guidance for assessing and understanding the dynamic impacts of proposed legislative and implementing measures should be strengthened, particularly risk-risk tradeoffs, incentives and obstacles to capital allocation; adjustment costs; health-health outcomes; and distributional impacts;

- **Ex Post Evaluation** – current requirements should be expanded to recognise and evaluate the foundational assumptions that underpin the European Green Deal.

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Richard Meads and Lorenzo Allio, the Rapporteur and Senior Policy Analyst at the European Risk Forum, wrote this Highlights Note. However, the views and opinions expressed in this paper do not necessarily reflect or state those of the European Risk Forum or its members.