The Ideas Exchange from Brussels

Squaring the Circle:

The transition to net zero in an era of inflationary pressure

Marco Buti
Head of Cabinet to the European commissioner for the Economy, Paolo Gentiloni

Jean Pisani-Ferry
Chair of the European University Institute and Senior Fellow at Bruegel

Carole Crozat
Head of Fundamental Research at BlackRock Sustainable Investing

Isabelle Mateos y Lago
Head of the Official Institutions Group at BlackRock

As part of an ongoing BlackRock event series exploring key questions and challenges facing Europe today, the recent Ideas Exchange from Brussels focused minds on how to achieve a green transition in a new era of entrenched inflationary pressure.

Europe is currently grappling with the trade-offs between short-term priorities – ensuring energy security and managing inflation – and long-term goals of achieving a carbon-neutral continent. It was precisely this balancing act that became the central part of the discussion; how can policymakers, stakeholders, and the global economy navigate current political and economic realities to continue pursuing a green transition?

Compounding crises: what impetus for net zero?

Isabelle Mateos y Lago, Global Head of the Official Institutions Group at BlackRock, opened the session highlighting Europe's role as a pioneer in decarbonisation. The EU was one of the first international bodies to pledge carbon neutrality by 2050 and aim to halve emissions by 2030. But the focus is now on implementation: undergoing the massive reallocation of resources needed for the fundamental transformation of Europe's industrial model.

The economic recovery from the Covid-19 pandemic has cast a long shadow over Europe's fiscal outlook and drew into sharp relief the real-life potential for environmental degradation to endanger its population. But rather than being a setback for the transition, the global crisis acted as a driver to accelerate EU action for greening the economy, with NextGenerationEU funding as the key mechanism.

Today's reality of soaring energy prices, supply chain disruptions and mounting geopolitical pressures has however exacerbated this challenge, highlighting Europe's vulnerabilities in energy security and heightening the inflationary pressures sparked by the pandemic. Crucially though, panelists agreed these challenges have only reinforced the need for long-term investment in renewables to achieve a net zero transition.

Navigating a transition path which is no longer linear

In this new context, panelists discussed the current geopolitical balancing act which has complicated Europe's path to net zero.

Marco Buti, Head of Cabinet to Commissioner Gentiloni, stressed that securing energy supplies and reducing the

> **"My takeaway from this discussion is that there is no desire [from the public or private sector] to deviate from the ultimate objective. It will be tough, requiring more public intervention and more spending than perhaps would have been initially anticipated due to the new constraints, but I am encouraged that you all seem to think that it's imminently manageable."**
>
> **Isabelle Mateos y Lago**, Global Head of the Official Institutions Group

> **“The big question is from a policy, institutional and also from a political perspective accepting the non-linearity of fossil fuels. It is obviously very delicate. There is the trade-off one has to manage between accelerating the green transition and at the same time reducing the dependency on Russian energy sources. The key issue is not to call into question the ultimate goal of decarbonisation”**
>
> **Marco Buti,** Head of Cabinet to Commissioner Gentiloni

continent’s dependency on Russian imports was currently top of mind for Europe. Europe’s RePowerEU Strategy aims to achieve this by accelerating investment in renewables, while turning to non-Russian sources of fossil fuel-based energy over the short term. It was the need for non-linearity that the speakers encouraged policymakers and stakeholders to reconcile.

Jean Pisani-Ferry, Chair of the European University Institute and Senior Fellow at Bruegel and the Peterson Institute, suggested that although public spending on fossil fuels should help secure Europe’s energy supplies in the short term to enable greater EU energy sovereignty, decarbonization should remain the priority. The private sector then should continue to strive for decarbonisation and invest more heavily in renewables which make greater economic sense as long term investments.

Carole Crozat, Head of Fundamental Research at BlackRock Sustainable Investing, expanded on the investor perspective, highlighting the need for investors to understand that in the long run, it is less inflationary and disruptive to invest in the transition than to leave it for later. Crozat emphasised the Ukraine crisis’ erosion of the so-called Green Premium, whereby heightened energy prices are mitigating the premium investors are paying for green assets. However, she noted the importance of practicing caution around this development, as potential short-term measures to promote fossil fuels in Europe can exacerbate the risk of stranded assets once the effects of current geopolitical tensions abate.

How to distribute EU, national and private sector investment

Europe has set out the necessary goals and targets for its green transition and energy sovereignty, the question now emerges around how these financing needs are met in practice. To meet Europe’s underlying target to reduce carbon emissions by 45% by 2030, Buti stressed that Commission modelling estimated EUR 390 billion worth of annual investment is needed, which amounts to an increase of investment-to-GDP ratio of roughly 2%.

Pisani-Ferry cast doubt over the utility of setting rigid ratios across investment needs at EU level, national governments and the private sector. He stressed that current estimations calling for one-third of investment being supplied by the public sector, with the remaining two-thirds covered by the private sector, should only serve as general guidance for policymakers, rather than firm policy.

At EU level, Buti noted that there is still substantial headroom in a number of the EU’s upcoming and ongoing financing initiatives. In the EU’s Recovery and Resilience plans, 37% of funding will be dedicated to the green transition, while there remains EUR 220 billion worth of loans still to be accessed in the NextGenerationEU framework.

Pisani-Ferry suggested that the EU facilitates investment via potential modifications to the Stability and Growth Pact (SGP), where one of the objectives in the upcoming negotiations will likely be to provide for a green investment incentive framework.

Securing the right incentives

To achieve the radical overhaul of Europe’s economy, panelists explored what incentives were needed. Crozat framed the question for investors around three main drivers of green investment: (1) understanding what consumers’ preferences will be; (2) mapping the differences in capital costs for incumbents compared to new technologies; and (3) what kinds of environment-specific policies will come out of public authorities.

> **“Most crucially, the costs of environmental externalities will need to be internalised. To date, our economy has been wired to maximise growth and minimize costs, but now new objectives must be considered, such as resiliency, security and long-term sustainability, and for that to happen the cost of the destruction of natural capital and other environmental assets such as a stable climate need to be factored in.”**
>
> **Carole Crozat**, Head of Fundamental Research at BlackRock Sustainable Investing

On wider policy incentives, Crozat and Pisani-Ferry agreed on the need for a long-term planning approach for issues such as energy subsidies, carbon pricing and large-scale industrial and infrastructural development projects, as a means to ensure adequate certainty for investors providing capital for the long term. As of yet, policymakers may not have provided this certainty for investors, and this would need to be resolved in order to unlock private capital for the future.

By way of example, Buti elaborated on the Carbon Border Adjustment Mechanism (CBAM) proposal as a prime example through which taxation, pricing and regulation can be used to ensure the smooth allocation of capital into sustainable assets – avoiding the risk of carbon leakage.

Squaring the circle

Marco Buti identified the optimisation of four elements, namely, allocation, redistribution, stability and security, as the key to square the circle.

Finally, Isabelle Mateos y Lago brought the roundtable to a close noting the clear agreement among panelists that Europe's goals for 2050 are still a top priority, but that indeed the path to a carbon-neutral Europe is no longer linear. The net zero transition will require more public intervention and spending than initially anticipated, but, crucially, it will be manageable. Investment from Europe, national governments and the private sector will all be needed in parallel to achieve energy security, control inflation and achieve a just green transition.

> **"Climate policy is suffering from a major credibility problem, private investors need to know the price of carbon not just today and tomorrow, but 10 years from now... We have to recognise that the idea that prices will drive the transition is in part an illusion. The idea that governments should not get involved is wrong [...]. The reality is different... [prices] are still needed, but this needs to be combined with regulation."**
>
> **Jean Pisani-Ferry,** Chair of the European University Institute and Senior fellow at Bruegel

This publication represents the regulatory and public policy views of BlackRock. The opinions expressed herein are as of May 2022 and are subject to change at any time due to changes in the market, the economic or regulatory environment or for other reasons. The information herein should not be construed as sales material, research or relied upon in making investment decisions with respect to a specific company or security. Any reference to a specific company or security is for illustrative purposes and does not constitute a recommendation to buy, sell, hold or directly invest in the company or its securities, or an offer or invitation to anyone to invest in any funds, BlackRock or otherwise, in any jurisdiction. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader.

In the **U.S.,** this material is available for public distribution. **In the UK and Non-European Economic Area (EEA) countries**, this is Issued by BlackRock Investment Management (UK) Limited, authorised and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Tel: + 44 (0)20 7743 3000. Registered in England and Wales No. 02020394, has issued this document for access by Professional Clients only and no other person should rely upon the information contained within it. For your protection telephone calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorised activities conducted by BlackRock. **In the European Economic Area (EEA),** this is Issued by BlackRock (Netherlands) B.V. is authorised and regulated by the Netherlands Authority for the Financial Markets. Registered office Amstelplein 1, 1096 HA, Amsterdam, Tel: 020 – 549 5200, Tel: 31-20-549-5200. Trade Register No. 17068311, has issued this document for access by Professional Clients only and no other person should rely upon the information contained within it. For your protection telephone calls are usually recorded. For qualified investors **in Switzerland**, this document is marketing material. This document shall be exclusively made available to, and directed at, qualified investors as defined in Article 10 (3) of the CISA of 23 June 2006, as amended, at the exclusion of qualified investors with an opting-out pursuant to Art. 5 (1) of the Swiss Federal Act on Financial Services ("FinSA"). For information on art. 8 / 9 Financial Services Act (FinSA) and on your client segmentation under art. 4 FinSA, please see the following website: http://www.blackrock.com/finsa.

In **Australia**, issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975, AFSL 230 523 (BIMAL). This material is not a securities recommendation or an offer or solicitation with respect to the purchase or sale of any securities in any jurisdiction. The material provides general information only and does not take into account your individual objectives, financial situation, needs or circumstances. Before making any investment decision, you should therefore assess whether the material is appropriate for you and obtain financial advice tailored to you having regard to your individual objectives, financial situation, needs and circumstances. BIMAL, its officers, employees and agents believe that the information in this material and the sources on which it is based (which may be sourced from third parties) are correct as at the date of publication. While every care has been taken in the preparation of this material, no warranty of accuracy or reliability is given and no responsibility for the information is accepted by BIMAL, its officers, employees or agents. Any investment is subject to investment risk, including delays on the payment of withdrawal proceeds and the loss of income or the principal invested. While any forecasts, estimates and opinions in this material are made on a reasonable basis, actual future results and operations may differ materially from the forecasts, estimates and opinions set out in this material. No guarantee as to the repayment of capital or the performance of any product or rate of return referred to in this material is made by BIMAL or any entity in the BlackRock group of companies. **In Singapore**, this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). **In Hong Kong**, this material is issued by BlackRock Asset Management North Asia Limited and has not been reviewed by the Securities and Futures Commission of Hong Kong. **In South Korea**, this material is for distribution to the Qualified Professional Investors (as defined in the Financial Investment Services and Capital Market Act and its sub-regulations). **In Taiwan**, independently operated by BlackRock Investment Management (Taiwan) Limited. Address: 28F., No. 100, Songren Rd., Xinyi Dist., Taipei City 110, Taiwan. Tel: (02)23261600. **In Japan**, this is issued by BlackRock Japan. Co., Ltd. (Financial Instruments Business Operator: The Kanto Regional Financial Bureau. License No375, Association Memberships: Japan Investment Advisers Association, the Investment Trusts Association, Japan, Japan Securities Dealers Association, Type II Financial Instruments Firms Association.) For Professional Investors only (Professional Investor is defined in Financial Instruments and Exchange Act). **In China**, this material may not be distributed to individuals resident in the People's Republic of China ("PRC", for such purposes, excluding Hong Kong, Macau and Taiwan) or entities registered in the PRC unless such parties have received all the required PRC government approvals to participate in any investment or receive any investment advisory or investment management services. For Other APAC Countries, this material is issued for Institutional Investors only (or professional/sophisticated /qualified investors, as such term may apply in local jurisdictions) and does not constitute investment advice or an offer or solicitation to purchase or sell in any securities, BlackRock funds or any investment strategy nor shall any securities be offered or sold to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. **In Latin America**, for institutional investors and financial intermediaries only (not for public distribution). This material is for educational purposes only and does not constitute investment advice or an offer or solicitation to sell or a solicitation of an offer to buy any shares of any fund or security and it is your responsibility to inform yourself of, and to observe, all applicable laws and regulations of your relevant jurisdiction. If any funds are mentioned or inferred in this material, such funds may not be registered with the securities regulators in any Latin American country and thus, may not be publicly offered in any such countries. The securities regulators of any country within Latin America have not confirmed the accuracy of any information contained herein. Investing involves risk, including possible loss of principal. The contents of this material are strictly confidential and must not be passed to any third party. Mexico. If any funds, securities or investment strategies are mentioned or inferred in this material, such funds, securities or strategies have not been registered with the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores, the "CNBV") and thus, may not be publicly offered in Mexico. The CNBV has not confirmed the accuracy of any information contained herein. The provision of investment management and investment advisory services is a regulated activity in Mexico, subject to strict rules, and performed under the supervision of the CNBV. BlackRock Mexico, S.A. de C.V., Asesor en Inversiones Independiente ("BLKMX") is a Mexican subsidiary of BlackRock, Inc., registered with the CNBV as an independent investment advisor under registration number 30088-001-(14085)-20/04/17, and as such, authorized to provide Investment Advisory Services. BlackRock México Operadora, S.A. de C.V., Sociedad Operadora de Fondos de Inversión ("BlackRock MX Operadora" and together with BLKMX, "BlackRock México") are Mexican subsidiaries of BlackRock, Inc., authorized by the CNBV. For more information on the investment services offered by BlackRock Mexico, please review our Investment Services Guide available in http://www.BlackRock.com/mx. Reliance upon information in this material is at your sole discretion. BlackRock México is not authorized to receive deposits, carry out intermediation activities, or act as a broker dealer, or bank in Mexico. Further, BlackRock receives revenue in the form of advisory fees for our mutual funds and exchange traded funds and management fees for our collective investment trusts.

BlackRock.