

HCSS GEO-ECONOMICS

## Why carbon pricing and climate-related disclosures are important for Dutch low-carbon action

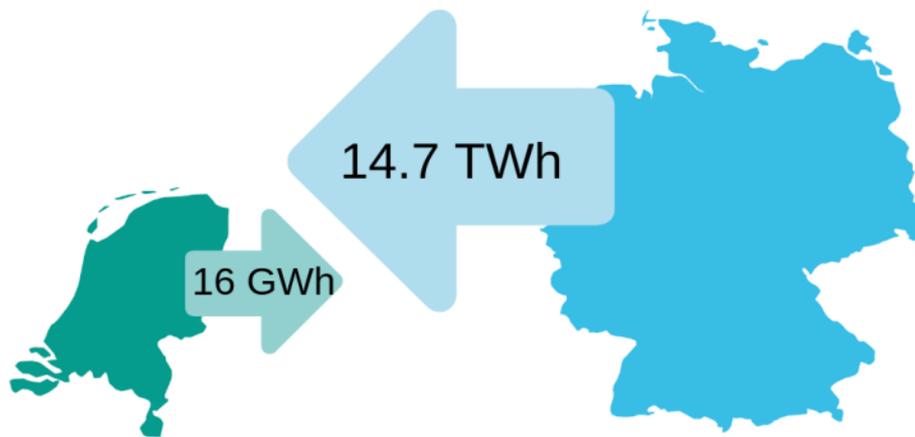
*Jan Frederik Braun & Lucia van Geuns*

On 10 July 2018 the Netherlands reached a general agreement on an ambitious national climate plan. This ‘agreement in principle’ is going to be developed into specific and coherent policy measures in the second half of 2018.

The Netherlands is an export-oriented country with an open economy and an industrial sector, which is highly integrated into global value chains. Responsible for around 40% of the total national energy consumption and corresponding CO<sub>2</sub> emissions, the industrial sector is also exceptionally large compared to other countries. Effective Dutch climate measures, therefore, require the creation of an EU and global level playing field.<sup>1</sup> For a small country like the Netherlands, a level playing field is the only option to have a meaningful impact on the global climate problem. Dutch climate action as a go-it-alone or purely national-oriented exercise hardly has any effect on reducing global greenhouse gas emissions (GHG).

Of the overall 49% reduction target of 48,7 Mt CO<sub>2</sub>-reduction compared to 1990 levels, the Dutch power and industry sectors have the largest reduction targets, i.e. 20,2 Mt CO<sub>2</sub> and 14,3 Mt CO<sub>2</sub> respectively.<sup>2</sup>

Regarding the Dutch industry and power sectors, the general agreement on the national climate plan acknowledges that the rules for these sectors do not stop at the border and that cooperation with neighbouring countries is important, for example with Germany (see figure 1 below).



*Figure 1: Dutch-German electricity exchange 2018. Source: Fraunhofer, 21 September 2018.*

In making the international competitive and energy-intensive Dutch industry sector more sustainable, the climate agreement also recognizes making use of European and international frameworks. In developing further policy instruments for sustainable industry operations, the agreement speaks of expanding on “clear carbon accounting principles and monitoring according to established and accepted rules”.<sup>3</sup> Both sectors are covered in the EU Emissions Trading System (EU ETS).<sup>4</sup> The ETS, which covers around 45% of the EU’s GHG, is the cornerstone of the EU’s policy geared towards reducing climate change. Electricity accounts for over 50 percent of EU ETS emissions.

In order to make optimal use of European and international frameworks and establishing a level playing field for effective national and international climate action. This paper argues that Dutch support is necessary in firstly; engaging effective carbon pricing<sup>5</sup>, and secondly; promoting European efforts to establish a singular approach in climate-related financial disclosures.

## Carbon pricing

The fact that the European Carbon Emission Allowance price, as traded within the ETS, has risen from less than EUR eight per ton of CO<sub>2</sub> in early 2018 to more than EUR 25 in September 2018 is a victory for the EU. In late 2017, the EU has passed some necessary ETS reforms after a decade-long slump in prices following the 2008 financial crisis.

Several factors have increased the carbon price recently. The most important factor is the EU’s creation of the so-called Market Stability Reserve (MSR). The MSR is designed to mop up excess emission allowances that have built up in the past decade. “By doing this it is forcing polluters to chase after a lower number of carbon credits to remain compliant with the scheme, which carries large financial penalties for those who fail to amass enough credits relative to the amount of carbon they produce.”<sup>6</sup>

Prices have also been boosted by the extreme warm weather in Europe over the summer. The 2018 summer heatwave has affected nuclear power generation in France, lowered hydropower levels in Scandinavia, and decreased wind speeds in Germany, which has resulted in the consumption of increased amounts of polluting fuel in order to compensate.<sup>7</sup>

Regarding effective carbon-pricing, however, the ETS is merely a means to an end. A common mistake made is that a high price for EU carbon allowances is used as a purpose, while EU ETS is only a tool to trigger carbon reduction. “The desired outcome is an ETS price of zero. After all, demand for these emission rights will drop to zero as soon as all processes will be decarbonized. The threat of a higher price for carbon emission allowances will help the energy intensive industries become more sustainable, but this cannot be a goal on its own.”<sup>8</sup>

For now, and in order to encourage fuel switching for industries, the carbon price needs to rise. Not convinced that the ETS price on its own will force the power sector and energy-intensive industry to become more sustainable, the Dutch government is planning to introduce a national minimum CO<sub>2</sub> price. Beginning at EUR 18 in 2020 and rising to EUR 43 by 2030, this price consists of a combination of the CO<sub>2</sub> price that follows from the ETS and a national levy.

For the sake of effective action in support of a level playing field, the art of unilaterally introducing a national carbon price floor is to translate this into joint policy of a group of prime movers. Supported by the example of Great Britain, which introduced a price floor that successfully tops up the ETS price, the Netherlands could persuade neighbouring countries to follow Dutch policy efforts and create a regional price floor. The first step is for these countries to adopt policies — with similar carbon prices and similar fine print — that will be easy to fold into a common policy with a broader ‘coalition of the willing’. The next step is to exert political pressure on other countries to join, most notably on Dutch neighbouring members of the Powering Past Coal Alliance<sup>9</sup> — including Belgium, Denmark, France, and Luxembourg.<sup>10</sup>

Through this bottom-up approach of the Netherlands, the prime mover group could put pressure on the entire EU to eventually reach a European minimum CO<sub>2</sub> price.

A more effective Dutch policy to promote a low-carbon economy, together with a leading group of European countries, is to make budget available and implement an ETS-flanking policy that allows for buying additional ETS emission allowances. For example, buying - and destroying - emission allowances that are released by the closure of Dutch coal-fired plants, but also by the construction of windmills. This has a price-boosting effect for carbon allowances and ensures a consistent level playing field.<sup>11</sup>

This ETS-flanking policy option was briefly mentioned in the Dutch government agreement of 10 October 2017, yet without allocation of budget.<sup>12</sup> No mention of this option is made in the general agreement on the Dutch climate plan.

## Climate-related disclosures

During the presentation of legislative proposals on sustainable finance in March 2018, the European Commission stated that the amount of catastrophe-related losses covered by insurance around the world reached an all-time high of EUR 110 billion in 2016, an 86 percent increase since 2007.<sup>13</sup>

As with carbon pricing, climate change poses an increasing financial burden on companies across sectors, including industry and power. Next to the increased pricing of GHG emissions and the severity of extreme weather events, climate-related risks include shifts in consumer preferences, increased cost of raw materials and the stigmatization of polluting sectors.

Increasing risks to investors posed by climate change coincides with the rise of green investing. Green investing considers environmental, social and corporate governance (ESG) criteria to generate long-term competitive financial returns and positive societal impact. ESG factors are a subset of non-financial performance indicators which include sustainable, ethical and corporate governance issues such as managing the company's carbon footprint and ensuring there are systems in place to ensure accountability. The environmental criteria in Figure 2 are particularly relevant for corporate low carbon action.<sup>14</sup>

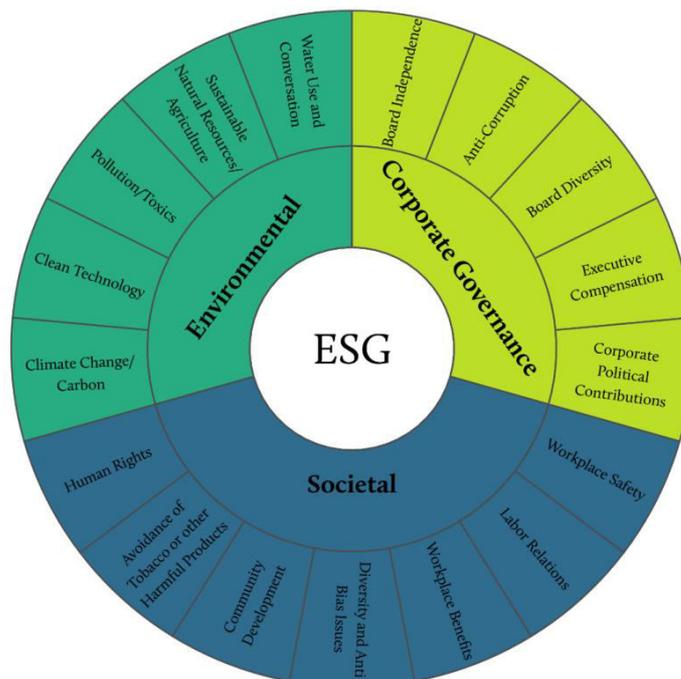
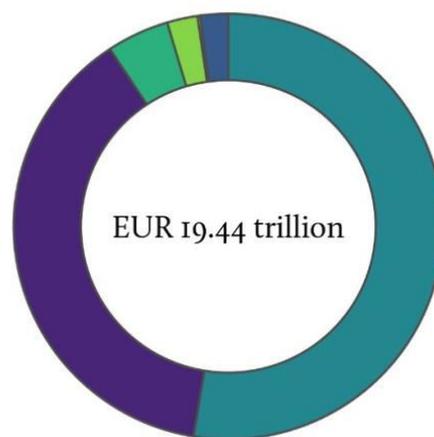


Figure 2: Examples of ESG criteria used by sustainable investors. Source: Forum for Sustainable & Responsible Investment (US SIF).

Most recent data from The Global Sustainable Investment Alliance 2016 shows that there are EUR 19.44 trillion of assets being professionally managed under responsible investment strategies, an increase of 25 percent since 2014.<sup>15</sup> In all the regions except Europe, which tightened its definition of sustainable investing, sustainable investing's market share has grown. In relative terms, responsible investment now stands at 26 percent of all professionally managed assets globally. So, it clearly constitutes a growing force across global financial markets (see Figure 3).



**Figure 3: Proportion of global sustainable, responsible and impact investing by region. Source: 2016 Global Sustainable Investment Review.**

At the moment, there are substantial differences in how investors, companies, banks, financial advisors and regulators look at ESG-risks.<sup>16</sup> A great number of guidelines are available that provide companies with insight into the climate effect of their total value chain, as well as ways to provide ESG-data to mainstream investors around the world.

Building on many of these existing climate-related disclosure regimes, the Taskforce on Climate-related Financial Disclosures (TCFD) has developed a singular and accessible framework.<sup>17</sup> It recommends four categories of climate-related financial disclosures that are applicable across sectors and jurisdictions (see Figure 4 below).

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organizations governance around climate-related risks	Disclose the actual and potential impacts of climate related risks and opportunities on the organisations businesses, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses and manages climate related risks	Disclose the metrics and targets used to assess and manage relevant climate related risks and opportunities where such information is material
Recommended Disclosures			
a) Describe the boards oversight of climate related risks and opportunities	a) Describe the climate related risks and opportunities the organization has identified over the short, medium and long term	a) describe the organizations processes for identifying and assessing climate related risks	a) disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process
b) Describe managements role in assessing and managing climate related risks and opportunities	b) describe the impact of climate related risks and opportunities on the organization's businesses, strategy and financial planning	b) describe the organizations processes for managing climate risks	b) Disclose Scope 1, Scope 2, and if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks
	c) describe the resilience of the organization's strategy, taking into consideration different climate related scenarios, including a 2°C or lower scenario	c) describe how processes for identifying, assessing, and managing climate related risks are integrated into the organizations overall risk management	c) describe the targets used by the organization to manage climate related risks and opportunities and performance against targets

Figure 4: Recommendations and supporting recommended disclosures. Source: TFCF, June 2017.

By standardizing the type of content disclosed across these categories – governance, strategy, risk management, and metrics and targets, TFCF incentivizes investors to make more and more decisions informed by climate risk considerations.<sup>18</sup>

Recent research in the annual reports of 45 listed companies in the Netherlands, however, shows that there is a lack of information regarding climate-related disclosures. Most of the companies give information about their CO2 emissions but significantly less about the actual and potential impact of climate-related risks on their own activities, organization, strategy and finances.<sup>19</sup>

With regard to the disclosure of GHG emissions, as recommended under Metrics and Targets in Figure 3, only half on the annual reports (i.e. 22 of 45) touch upon the entire chain of emissions (scope 1-3).<sup>20</sup> In particular, information about scope 3, i.e. indirect CO2 emissions due to the purchase of services and products from third parties, is omitted.

Regarding Risk Management, 6 of the 45 companies pay specific attention to climate change. Six other companies are (very) brief in this respect and the vast majority - almost three-quarters of the companies - pay no attention to climate change in their respective annual reporting whatsoever.

The seven Dutch companies that provide explanations from the TCFD framework do so without fully considering the numerous material, financial and strategic risks of climate change as elaborated by the Taskforce, as mentioned above. The conclusion is that most Dutch listed companies do not provide climate-related information alongside their mainstream financial filings. Due to the growing importance of climate-related disclosure, there is clearly much room for improvement among Dutch companies.

TCFD has made great waves over the last year, going beyond corporations and investors to empower cities, governments and regulators to increase the quality and quantity of climate-related financial disclosures. The European Commission and the governments of Canada, China, France, Sweden and the UK have all made public statements of support and are beginning to explore ways of implementing the TCFD's recommendations. Yet there is still some way to go before we reach the tipping point where all investors, businesses, states and jurisdictions are using TCFD as a standard tool. In its ambition to expand on clear carbon accounting principles and monitoring, the Netherlands should support international efforts in making the TCFD's recommendations the established and accepted rules for climate-related disclosures.<sup>21</sup>

## Conclusion

Together with effective carbon pricing, climate-related disclosure should be a key pillar of the Dutch commitment to developing a highly ambitious climate agreement in the second half of 2018 and first half of 2019. Both are vital tools in establishing an EU and global level playing field for climate action. On such a platform the Netherlands could contribute in a meaningful way to the lowering of global CO2 emissions.

*Dr. Jan Frederik Braun is Strategic Energy Analyst and Lucia van Geuns is Strategic Energy Advisor at:  
The Hague Centre for Strategic Studies (HCSS).*

<sup>1</sup> [Jan Frederik Braun & Lucia van Geuns, Effective Dutch climate measures require an international approach, HCSS Energy Transition Program, Paper Series June 2018.](#)

<sup>2</sup> Other Dutch sectors complementing the overall 49% reduction target are the following: Mobility (7,3 Mt CO<sub>2</sub>), Agriculture (3,5 Mt CO<sub>2</sub>) and buildings (3,4 Mt CO<sub>2</sub>).

<sup>3</sup> [General agreement on the climate accord](#) (in Dutch).

<sup>4</sup> The [ETS](#) operates in the 28 EU countries plus Iceland, Liechtenstein and Norway. It limits GHG from approximately 11.000 energy intensive installations in power generation and manufacturing industry sectors and operators of flights to and from EU Member States, Iceland, Liechtenstein and Norway.

<sup>5</sup> LCE is an economy based on low carbon power sources that therefore has a minimal output of GHG emissions into the biosphere.

<sup>6</sup> [David Sheppard, Carbon price hits decade high in boost for cleaner fuels, Financial Times 29 August 2018.](#)

<sup>7</sup> *Ibid.*

<sup>8</sup> [ABN AMRO Energy Monitor, 12 September 2018.](#)

<sup>9</sup> [Powering Past Coal Alliance: Declaration.](#)

<sup>10</sup> [Robert Ritz and Arthur van Benthem, Europe needs a minimum price on carbon emissions, Handelsblatt Global, 25 July, 2018.](#)

<sup>11</sup> [Hans van Cleef, Een minimale CO<sub>2</sub>-prijs verhult de echte oplossing, energiepodium.nl, 30 august 2018.](#)

<sup>12</sup> [Regeerakkoord Vertrouwen in de toekomst, 10 oktober 2017.](#)

<sup>13</sup> [European Commission, Sustainable finance: Making the financial sector a powerful actor in fighting climate change, Brussels, 24 March 2018.](#)

<sup>14</sup> [FT.com/lexicon, Definition of ESG.](#)

<sup>15</sup> [Global Sustainable Investment Alliance, 2016 Global Sustainable Investment Review.](#)

GSIA is collaboration of membership-based sustainable investment organizations around the world. Members include the Dutch Association of Investors for Sustainable Development (VBDO) and US SIF.

<sup>16</sup> Jim Hempstead – Taking Stock of ESG Risks for Utilities from Columbia Energy Exchange in Podcasts. 8 October 2018: <https://itunes.apple.com/de/podcast/columbia-energy-exchange/id1081461629?l=en&mt=2&i=1000421335261>.

<sup>17</sup> The TCFD recommended disclosures are in alignment with existing voluntary and mandatory climate-related reporting frameworks such as the CDP (Carbon Disclosure Project) and the Global Reporting Initiative (GRI).

<sup>18</sup> [TFCD, Recommendations of the Task Force on Climate-related Financial Disclosures, Final Report, June 2017.](#)

<sup>19</sup> [Dick de Waard, Klimaatverandering verovert een plekje in het jaarverslag, NBA Accountants in business, 17 August 2018.](#)

<sup>20</sup> Scope 1 refers to all GHG emissions arising directly from a company's business activities, i.e., from the consumption of primary energy carriers and process emissions resulting from the production process (e.g., the production of steel and concrete). Scope 2 refers to indirect GHG emissions arising from the generation of all grid bound energy purchased by the company. Source: [Götz \*et al.\*, Corporate Climate Action: A step-by-step guide for companies, Global Compact Network Germany, December 2017.](#)

<sup>21</sup> [Jane Stevensen, TCFD advances Carbon Disclosure Project, top1000funds.com, 2 May 2018.](#)