

| HCSS Geo-economics

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

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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 CO₂ 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.¹ 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 CO₂-reduction compared to 1990 levels, the Dutch power and industry sectors have the largest reduction targets, i.e. 20,2 Mt CO₂ and 14,3 Mt CO₂ respectively.²

With regard to 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 neighboring countries is important, for example with Germany (see figure 1 below).

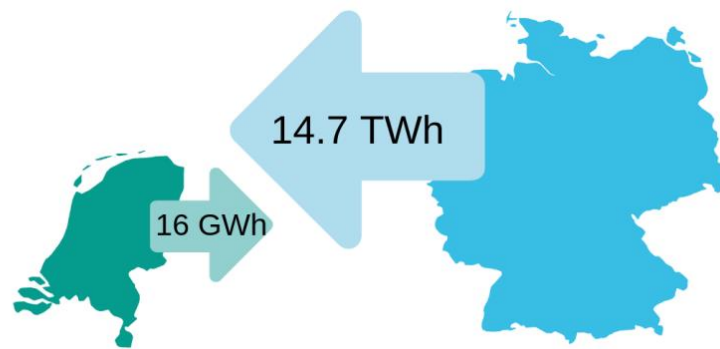


Figure 1: Dutch-German electricity exchange 2018 (Source: Fraunhofer, 21 September 2018).

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”.³ Both sectors are covered in the EU emissions trading system (EU ETS).⁴ The ETS, which covers around 45% of the EU’s GHG, is the cornerstone of the EU’s policy to combat 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 and secondly, promoting 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 CO₂ 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 financial crisis.

A number of factors have sent the carbon price higher. 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 has 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.”⁵

Prices have also been boosted by extreme weather in Europe over the summer. With the heatwave affecting nuclear power generation in France, lower hydropower levels in Scandinavia, and lower wind levels in Germany has meant that more polluting fuels were burnt to compensate.⁶

With regard to effective carbon-pricing, however, the ETS is merely a means to an end. A common mistake made is that targeting 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.”⁷

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 CO₂ price. Beginning at EUR 18 in 2020 and rising to EUR 43 by 2030, this price consists of a combination of the CO₂ 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 neighboring 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 neighboring members of the Powering Past Coal Alliance⁸ — including Belgium, Denmark, France, and Luxembourg.⁹

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 CO₂ 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.¹⁰

This ETS-flanking policy option was briefly mentioned in the Dutch government agreement of 10 October 2017, yet without allocation of budget.¹¹ 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 2007.¹²

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

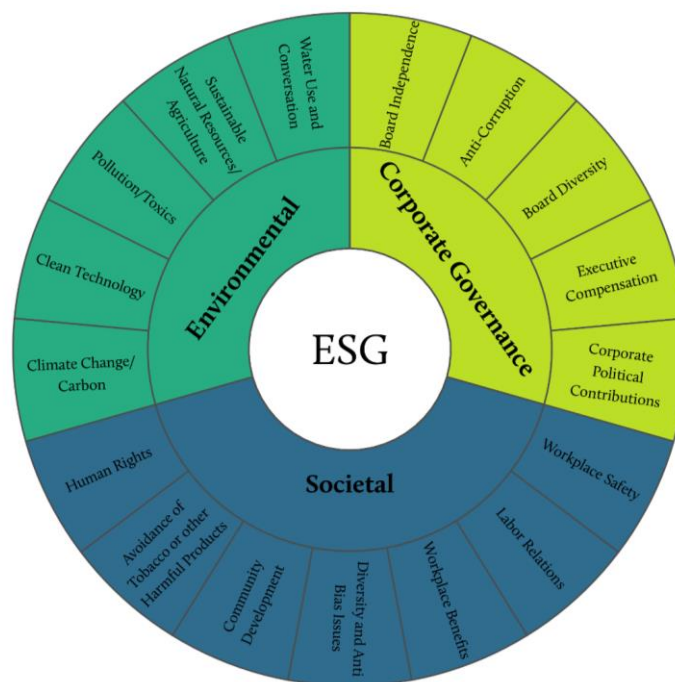


Figure 2: Examples of ESG criteria used by sustainable investors. Source: Forum for Sustainable & Responsible Investment (US SIF).

Increasing risks to investors posed by climate change explains 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.¹³

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 2014.¹⁴ 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).

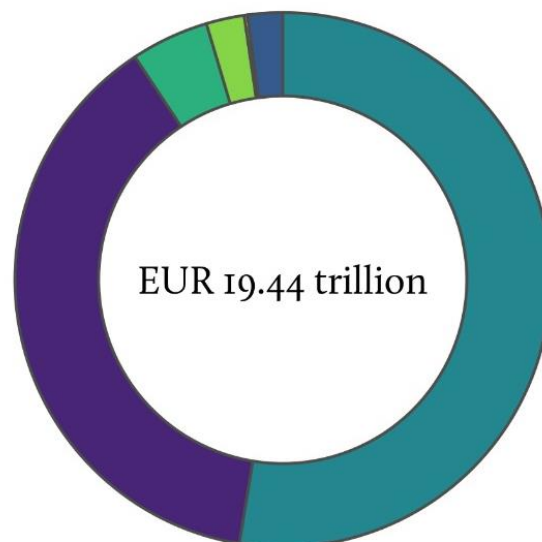


Figure 3: Proportion of global sustainable, responsible and impact investing by region.

Source: 2016 Global Sustainable Investment Review.

At the moment, there are very big differences in how investors, companies, banks, financial advisors and regulators look at ESG-risks, hence the sustainability of an organization over a long-term period of time.¹⁵ 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.¹⁶ It recommends four categories of climate-related financial disclosures that are applicable across sectors and jurisdictions (see Figure 4). By standardizing the type of content disclosed across these categories – governance, strategy, risk management and metrics and targets, TCFD enables investors to make more and more decisions that integrate climate risk into them.¹⁷



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

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 much less about the actual and potential impact of climate-related risks on their own activities, organization, strategy and finances.¹⁸

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).¹⁹ 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. 6 other companies are (very) brief in this respect and the vast majority - almost three-quarters of the companies - pay no attention to this in their respective annual reporting.

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 the vast majority of 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, nations and jurisdictions are using TCFD as a standard tool.²⁰ 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.

Conclusion

Together with effective carbon pricing, climate-related disclosure should be key pillars of the Dutch commitment to developing a highly ambitious climate agreement in the second half of 2018. Both are vital tools in establishing an EU and global level playing field for climate action, on which the Netherlands can compete in a meaningful way for lower global CO₂ emissions.

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

² Other Dutch sectors complementing the overall 49% reduction target are the following: Mobility (7,3 Mt CO₂), Agriculture (3,5 Mt CO₂) and buildings (3,4 Mt CO₂).

³ [General agreement on the climate accord](#) (in Dutch).

⁴ 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.

⁵ [David Sheppard, Carbon price hits decade high in boost for cleaner fuels, Financial Times 29 August, 2018.](#)

⁶ *Ibid.*

⁷ [ABN AMRO Energy Monitor, 12 September 2018.](#)

⁸ [Powering Past Coal Alliance: Declaration](#)

⁹ [Robert Ritz and Arthur van Benthem, Europe needs a minimum price on carbon emissions, Handelsblatt Global, 25 July, 2018.](#)

¹⁰ [Hans van Cleef, Een minimale CO₂-prijs verhult de echte oplossing, energiepodium.nl, 30 august 2018.](#)

¹¹ [Regeerakkoord Vertrouwen in de toekomst, 10 oktober 2017.](#)

¹² [European Commission, Sustainable finance: Making the financial sector a powerful actor in fighting climate change, Brussels, 24 March 2018.](#)

¹³ [FT.com/lexicon, Definition of ESG.](#)

¹⁴ [Global Sustainable Investment Alliance, 2016 Global Sustainable Investment Review.](#)

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

¹⁵ 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>.

¹⁶ 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).

¹⁷ [TCFD, Recommendations of the Task Force on Climate-related Financial Disclosures, Final Report, June 2017.](#)

¹⁸ [Dick de Waard, Klimaatverandering verovert een plekje in het jaarverslag, NBA Accountants in business, 17 August 2018.](#)

¹⁹ 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.](#)

²⁰ [Jane Stevensen, TCFD advances Carbon Disclosure Project, top100ofunds.com, 2 May 2018.](#)