The "European Green Deal" through the lens of thematic research

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The Green Deal is a new comprehensive strategy of the EU Commission, set to govern its actions for decades to come. It aims to establish the EU (European Union) as a global leader through a transition towards a green and digital economy, outlining the EC's guiding principles for policy making, regulation, allocation of investments, diplomatic engagement and strategic initiatives. This transition is aligned with the EU's climate goals from the Paris agreement on climate change as well as with the UN's 2030 agenda and SDGs (Sustainable Development Goals).

We have identified four opportunities arising from the Green Deal that are strongly inter-linked and closely aligned with our thematic investing approach, which features strategies focused on a political, social or environmental growth trend. These opportunities are:

1. **Decarbonisation.** To achieve ambitious climate targets, the decarbonisation of the EU economy is of paramount importance. The focus is on those industries with the highest share of greenhouse gas (GHG) emissions.
   The Green Deal's stated aims include:
   - The build-out of renewable **energy** sources – in lockstep with power storage systems and smart and interconnected energy networks
   - Decarbonisation of the **transport** sector and the modernisation of heavy industries
   - Promotion of sustainable, resource-efficient and high-quality **agriculture**
   - Encouraging member states to start a "renovation wave" to increase the energy and resource efficiency of **buildings**

Key takeaways

- The EU Green Deal is a blueprint that will push all industry sectors towards more sustainable business models
- The shift towards sustainability will require significant financial investment, providing opportunities for investors
- The growing universe of firms enabling the transition towards a more sustainable economy can be grouped around identifiable investment themes
- A thematic approach, featuring strategies focused on a political, social or environmental growth trend, could help investors better identify potential winners and losers

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2. **Circular economy.** Transitioning from a linear throughput model to a **regenerative, circular model** (ie, aiming to eliminate waste through the re-use of resources] will increase energy- and resource-efficiency. The EU envisions products that are designed to be **durable, repairable, reusable and recyclable**, and intends to increase its own capabilities around waste collection, processing and recycling. Further, it aims to create an internal market for secondary raw materials.
3. **Preservation of ecosystems and biodiversity:** The guiding principle is that "all EU policies should contribute to preserving and restoring Europe's natural capital". Direct focus areas include forestry, sustainable agriculture without the use of harmful substances and a sustainable "Blue Economy", which unlocks the full potential of aquatic and marine resources while ensuring healthy and resilient seas and oceans.
4. **Digitalisation:** Digital tools will be essential enablers in three ways. They can help to:
   - **Monitor progress** on the targets to facilitate swift and evidence-based decision making
   - Raise **awareness and empower consumers** by increasing transparency of product sustainability characteristics
   - Increase the **energy-and resource-efficiency** of various processes through **automation and digitalisation**. To unlock the full potential of the technological revolution, the rollout of 5G infrastructure will be a necessary prerequisite.

While the EU's regulatory reach extends only to its member states, the EU aims to use its diplomatic and economic power to shape international standards and promote this sustainable agenda among its international partners. That way, it seeks to ensure a level playing field globally to avoid being made to compromise on the achievement of its goals due to regional variations in levels of ambition.

Introduction

Only days after Ursula von der Leyen took office as President of the European Commission in December 2019, she presented the Green Deal, a fundamental strategic programme designed to dominate policy in Europe for decades. Though the title "green" rightly indicates a strong emphasis on environmental objectives, this initiative essentially outlines a strategy for a green and digital transition of the EU economy, including social and diplomatic issues. Mrs Von der Leyen herself made it her flagship policy and even dubbed it "Europe's man on the moon moment"; it therefore warrants closer scrutiny.

"Though the title indicates an emphasis on environmental objectives, the Green Deal also outlines a strategy for a digital transition"

The objective of this paper is to uncover the likely impact on investment cases and identify sectors that could be sensitive to any potential changes that the Green Deal's implementation might cause. It is crucial to highlight that this paper does not reflect all the measures of the Green Deal, but rather explores the most investible themes from a thematic perspective.

It is important to highlight that, while the rise of the Covid-19 pandemic in Europe has affected the timeline of the Green Deal and delayed the introduction of some of its underlying policies, the European Recovery Fund – which EU leaders agreed upon after marathon negotiations in July – is strongly tied to the Green Deal objectives. This will give an additional boost to the Green Deal's agenda by unlocking further funding and giving the commission a lever to ensure that the national recovery plans are aligned with the Green Deal. While this is a process that might take some time to unfold, management consultancy firm McKinsey has provided analysis into how the combination of stimulus and Green Deal could work.[1]

Objectives of the Green Deal

The Green Deal is designed to position the EU as a future global leader with a green and digital economy, and thereby tackle climate and environmental challenges. At its very core, the initiative targets net zero emissions by 2050 and aims to "protect, conserve and enhance the EU's natural capital, and protect the health and well-being of citizens from environment-related risks and impacts".[2] It is also closely aligned to the UN's 2030 Agenda – which commits to eradicating poverty and achieving sustainable development by 2030 – and the Sustainable Development Goals (SDGs)[3], as well as the Paris agreement on climate change, which aims to strengthen the global response to the threat of climate change.[4] In essence the Green Deal goes beyond simply having a single focus on the environmental action required to achieve decarbonisation and pollution reduction; it also details the stakeholders involved while outlining a roadmap for financing. There is also an element of industrial policy towards research and development in new technological fields such as battery technology, resource security and digitalisation[5].

Implementation of the Green Deal

At this stage the Green Deal is seen as a high-level initiative by the European Commission which consists of various policy initiatives and action plans. These elements need some refinement and, even more importantly, must still overcome several political hurdles. Given the structure of the European Union's political architecture, the EC's proposal needs the approval of member states' national governments and the European parliament. Like the adoption of the 2050 climate neutrality target, pushing the proposals through might prove to be a multilateral balancing act that requires extensive negotiation around budgets and compensation payments.

"The EC has set out a stringent timetable, in which 2020 appears to be the key year to make progress"

On the breakdown of single measures, however, the Commission has set out a stringent timetable, in which 2020 appears to be the key year to make progress[6]. In reaction to the changed circumstances deriving from the Covid-19 pandemic, the European Commission continues to update its timetable[7].

Funding of the Green Deal

The European Green Deal will require significant financial investment, which will be mobilised by the Sustainable Europe Investment Plan: the Commission aims to unlock at least EUR 1 trillion over the next decade[8]. Roughly half of this amount will be provided directly from the EU budget while the remainder will come from the InvestEU programme, which is designed to bring together under one roof the various financial instruments available to the EU: development banks, national governments and private investments. To unlock the maximum possible investment support from the private sector, the EU Commission has launched its "consultation on the renewed sustainable finance strategy"[9], which aims to provide greater clarity regarding the policy refinements necessary to speed up the transition of the financial system towards sustainability. Further, the EU stresses that the transition should be just and inclusive, leaving no one behind. Therefore, in addition to the above, a Just Transition Mechanism is proposed, which will provide practical and financial support (at least EUR 100 billion budgeted) for the most affected regions whose economies rely heavily on carbon-intensive industries (eg, lignite mining areas).

As previously mentioned, the EU's fiscal response to the Covid-19-crisis, dubbed "Next Generation EU", will provide a further source of financing and should give an additional boost to the Green Deal agenda. One reason for this is that the final agreement on both recovery plan and the next mid-term financial budget (MFF) includes a requirement of spending at least 30% of the entire package on climate protection, which could total more than USD 0.5trn spent on climate between 2021 and 2027. Moreover, member countries need to submit their national recovery and reform plans in order to unlock their allocation of funds of the so-called Recovery and Resilience Facility, worth EUR 312.5bn in grants. The commission has made clear that it expects those plans to be tied to the green and digital objectives of the Green Deal.

Investment implications

We have identified four major investment areas from the Green Deal; they are strongly interlinked and consist of various individual details. Often, the Green Deal outlines the general concept and principles according to which the economy should be structured, along with some "high-priority" sectors that play a crucial role for a successful transition. However, the concepts apply more generally and should ultimately be applied to all sectors. Consequently, almost all business models will likely be affected by the Green Deal and its related policies. In the following section, we give a breakdown of the four overarching investment areas, which themselves can be broken down into more granular topics.

"Almost all business models will likely be affected by the Green Deal and its related policies"

1. **Decarbonisation**
   To move closer to the 55% emission reduction target set out for 2030, or carbon neutrality by 2050, it makes sense to identify the heavy emitters[10]:

Energy sector

Power generation is a key industry, contributing almost 30% of overall greenhouse gases in the EU . Meaningful progress here would involve a dramatic build-out of **renewable energy sources** like solar and wind in lockstep with **power storage systems** and **smart and interconnected distribution networks**, which tackle the intermittency issues resulting from reliance on weather conditions, and which enable the efficient and stable balancing of supply and demand to ensure secure, affordable **green energy** across Europe.

Transport

Transport still relies heavily on fossil fuels. With the emergence of **electric vehicles**, this dependency might slowly decrease. For other applications like heavy freight or air travel, the rise of **hydrogen**-based mobility or **alternative fuels** might offer ways to reduce carbon footprints. Further, shifting freight transport increasingly from road to rail and inland waterways, setting more stringent GHG-emission standards for combustion-engine vehicles, and ramping up the offering for alternative modes of transport will contribute to achieving the targeted 90% reduction in emissions in the transport sector by 2050.

Industrial processes: Transition of steel, chemicals and cement

Heavy industries like steel, chemicals or cement are significant emitters of greenhouse gases as their production processes largely rely on coal, oil or gas as fuel. These industries will remain large energy consumers; the EC's objective is to change the source of energy to a preferable solution in terms of emissions, and to encourage innovation for alternative production processes. For example, cement or steel could switch to **electricity** or **hydrogen power**. The "industrials strategy"[11] outlines the proposed pathway for the twin transition towards a green and digital industrial sector. Further, the shift from a linear throughput model towards a circular economy with repairable, reusable and recyclable products, coupled with a European market for secondary raw materials, will help facilitate the decarbonisation of the industrial sector. Lastly, the digital transformation should be leveraged to empower the consumer in making informed choices and incentivising the transition, by providing clear and reliable information on the sustainability credentials of a product.

Sustainable agriculture

Europe should continue setting the standard for **safe, nutritious, high-quality and sustainable food**. The "farm-to-fork strategy"[12] is a key pillar of the Green Deal, focused on accelerating the transition to a more sustainable food production system, which should increase the contribution of the agricultural and fisheries sector to climate action. This strategy will help these sectors reduce their footprint by helping them adopting sustainable practices such as precision agriculture, organic farming, agro-ecology and agro-forestry, and stricter animal welfare standards. Eco-schemes should reward farmers for improved environmental and climate performance.

Buildings

As buildings currently account for roughly 40% of energy consumption across the EU, it encourages member states to engage in a **"renovation wave"** of public and private buildings to **increase** the **energy-and resource-efficiency of buildings** by using sustainable raw materials, applying circular concepts and leveraging digital technologies.

Further regulatory initiatives to help achieve the objectives include a review, revision and possible extension of the emissions trading system (ETS) by June 2021, to cover sectors such as buildings/construction, maritime and traffic. The establishment of a Carbon Border Adjustment Mechanism to address the risk of carbon leakage is also proposed.

2. **Circular Economy**

   In the Circular Economy Action Plan[13], the Commission outlines its ambition to accelerate the transition towards a regenerative, circular economic model in order to decouple economic growth from resource use, which thus allows to square the circle of climate neutrality and economic prosperity. A circular European Economy is estimated to increase EU GDP by an additional 0.5% by 2050 and create 700 000 new jobs.[14]

The circular concept is based on products that are durable, safe and designed for **reusability** (restricting single-use plastics), **repairability** (ensuring customers have the "right to repair" instead of being forced to replace products) and high-quality **recycling** (by setting targets for recycled share). The concept aims to reduce waste production and increase energy- and resource-efficiency. These principles will be integrated into the Sustainable Product Policy (expected in 2021), which will be based on the Ecodesign framework, which provides consistent EU-wide rules for improving the environmental performance of products.[15] Further, leveraging digitalisation's potential should provide consumers with the relevant information to make an informed decision, while enabling producers to track, trace and map resources. The EU aims to stop the shipping of waste outside the EU and **increase** the **waste collection, processing and recycling capabilities** inside the bloc (eg, by harmonising separate waste collection systems). The EU also aims to create an internal market for high-quality secondary raw materials, and will encourage innovative solutions and business models, such as "product-as-a-service", which enables customers to buy a service delivering an end product, rather than the product itself.

The initiatives will again focus on the sectors where the highest impact can be achieved, including:

a. **Electronics and ICT (information and communications technology):** devices should be designed to be energy-efficient, durable, repairable (right to repair) and recyclable. The introduction of a standard universal charger across electronic devices, and the initiation of a take-back/ return market for old devices should reduce electronic waste.

b. **Batteries and vehicles:** legislative proposals will build on and support the work of the Battery Alliance, which brings together stakeholders to build a strong and competitive battery industry. The goal is to phase-out non-rechargeable batteries and take measures to increase recycling rates and improve collection rates. Sustainability and transparency requirements (carbon footprint, material sourcing, etc) should also provide guidance for consumers.

c. **Packaging:** packaging should be designed for re-use and recyclability, reducing (over)packaging and waste by setting targets and restricting certain packaging materials (eg, no single-use plastic). A harmonisation of collection systems should facilitate better processes for sorting and recycling packaging waste.

d. **Plastics:** mandatory requirements and bans will be set for recycled content and waste-reduction measures in key products (packaging, construction materials, vehicles) – as seen in the directive on banning single-use plastics, for example.[16] A focus will be on eradicating micro-plastics, while the use of biodegradable plastics will be encouraged.

e. **Textiles:** The goal is to design products that are fit for circularity, ensure the uptake of secondary raw materials and tackle the presence of hazardous raw materials. Customers should be empowered to make informed choices, boosting the sorting, re-use and recycling of textiles.

f. **Constructions and buildings:** The introduction of recycled content requirements and material recovery targets should ensure greater material efficiency, and the integration of life-cycle assessments in public procurement guidelines should offer incentives.

g. **Food, water and nutrients:** the EU will propose targets for the reduction of food waste, substitution of single-use packaging, tableware and cutlery in food services, and promotion of circular approaches in water use within agriculture.

3. **Preserving and restoring ecosystems and biodiversity**

   The EU recognises that ecosystems must be preserved and protected against the exploitation of natural resources and climate change. Biodiversity is crucial to our global ecosystem, so the Green Deal's "biodiversity strategy"[17] outlines the EU's targets and commitments to **protect and restore ecosystems** and **prevent biodiversity loss**. Most notably, these include the establishment of a coherent EU-wide network of protected areas covering at least 30% of EU land and 30% of EU seas, as well as an EU Nature Restoration plan. Further, the Green Deal says that **all future EU policies should contribute to preserving and restoring Europe's natural capital**. This includes the following areas:

Forestry
The Green Deal's "forest strategy" will promote effective and sustainable afforestation, forest preservation and restoration to improve the quantity and quality of the EU's forested areas, which are crucial to achieve its climate and biodiversity ambitions and to keep the ecosystem healthy.

Agriculture
There is a strong link between the "biodiversity strategy" and the "farm-to-fork strategy". Policy priorities include sustainable farming without the use of chemical pesticides, fertilisers and antibiotics, and a target to achieve at least 25% coverage of organic farming practices on EU's agricultural lands by 2030.

Sustainable "blue economy"
Reducing the adverse impacts of fisheries, and using the full potential of aquatic and marine resources (eg, production of new protein sources, offshore wind, etc) in a sustainable way will help ensure healthy and resilient oceans, seas and coastal ecosystems.

Green urban spaces
European cities are encouraged to integrate green spaces into their urban landscape planning. The EU "urban greening platform" should serve as a facilitator and coordinator of these efforts.

" Investing in nature protection and restoration will be critical for Europe's economic recovery from the Covid-19 crisis"

In the "biodiversity strategy", the Commission acknowledges that "investing in nature protection and restoration will also be critical for Europe's economic recovery from the Covid-19 crisis [as] protecting and restoring biodiversity and well-functioning ecosystems [...] is key to boosting our resilience and preventing the emergence and spread of future diseases."[18] Further, a research survey of 231 central bank officials, finance ministry officials and other economic experts from 53 countries (including all G20 countries) found that "natural capital investment for ecosystem resilience and regeneration" is among the top five recommended policy items offering a high economic multiplier as well as a positive climate impact.[19]

4. **Digitalisation – leveraging technology to monitor progress, raise awareness and increase efficiency**
   The EU sees **digital transformation and tools as essential enablers** of the targeted changes and aims to leverage the full potential of the technological revolution, which will help in three ways:

Monitor progress
The collection of data, automatic monitoring, and creation of dashboards should provide a comprehensive overview and understanding of progress on the targets (eg, air and water pollution, energy and resource use). This will also help ensure timely identification of any areas where further action is needed. Also, predictive modelling can help understand the potential impact of certain actions (or inactions) and enable evidence-based decision making.

Raise awareness and empower consumers
Sophisticated technological solutions should provide the consumer with relevant information to help them make informed decisions, eg, by providing **transparency** on the carbon footprint, raw material sourcing and any product's circular characteristics (repair, reuse, recycle options).

Increase efficiency
Automation and digitalisation can increase the **energy- and resource-efficiency** of manifold different processes, in particular in the key sectors of agriculture, energy and transport. Examples of applications include: **smart energy networks** balancing energy supply and demand and enabling regional and cross-border collaboration/ cooperation, **smart buildings** efficiently regulating electricity and heating, **smart traffic networks** to increase efficiency of distribution networks and reduce pollution from congestion, etc.

The EU will support research efforts for the **development of innovative use cases** that help achieve the objectives outlined in the Green Deal. A particularly important role is assigned to small and medium-sized businesses (cf. A New Industrial Strategy for Europe[20]), which can help more traditional industrial businesses to adapt their business models to the digital age and develop new forms of work.

As the commission has outlined, **state-of-the art** (wide-reaching, fast and secure) **connectivity** is the fundamental building block of the digital transformation. Further, the EU's "digital strategy"[21] aims to ensure that the same standards of openness, inclusiveness and fairness that have been the cornerstone of a trustworthy and prosperous offline market also apply to the online/digital market. The vision is to have **coherent EU-wide rules and standards**, a "single market for data" [22] that allows consumers to control and take responsibility for their data while giving the industry access to data pools to advance their business model, underpinned by policies that ensure that international players entering the European market respect the rules. Overall, this should allow a **green and digital future** for Europe that is beneficial for all stakeholders.

Negative screening criteria

It is worth mentioning that the EU aims to promote those activities that help achieve the Green Deal's objectives while at the same time **not significantly harming** the achievement of any of the other objectives, such as decarbonisation, preservation of ecosystems and biodiversity, reduction of waste and pollution. Business activities that have a negative impact on or hamper the achievement of one of the objectives will face regulatory and political headwinds. Therefore, the potential adverse impact of a company's activity on the Green Deal's objectives should always be critically assessed when evaluating the overall footprint and/or handprint (the extent to which a company's products or services help reduce their customers' footprint).

Green diplomacy

The commission also aims to put the considerations outlined in the Green Deal at the heart of its diplomatic agenda, to serve as a front runner, **set new sustainability standards** and leverage its diplomatic and economic (as the world's largest single market) power to encourage other states and regions to follow its sustainable path. It will step up efforts to achieve both the SDGs and the goals from the Paris Agreement. This should be achieved by **diplomatic engagement** and **strategic partnerships**, but the desire for progress will also be reflected in EU trade policy, where the commission proposes that all future **trade agreements** include a binding commitment of all parties to ratify and effectively implement the Paris Agreement.

Conclusion

"The Green Deal will be a key driver for change affecting all sectors; investment cases should be revisited to assess the risk of companies unlikely to undergo a successful transition"

The European Green Deal will be a key driver for change and transformation affecting all sectors and industries and further strengthening the secular trend towards a more sustainable and digital economy. From an investor perspective, this implies that investment cases should be revisited to assess the risk of companies that are unlikely to undergo a successful transition. On the other hand, it also creates investment opportunities, which can be captured by taking a thematic approach and actively selecting companies whose core business is able to significantly contribute to the EU Green Deal roadmap and which is also aligned with the UN's SDGs. The growing universe of firms engaged in these areas represents an attractive opportunity to participate in the transition towards a more sustainable economy and benefit from the underlying growth potential.

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Data as at March 31, 2020

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