# Statement for meeting with Chancellor Angela Merkel
# Berlin 9th May 2012

**Lord Nicholas Stern, I.G. Patel Professor of Economics and Government, LSE**

The European Union has reached a critical point in its history, facing simultaneously a severe political-economic crisis, and its biggest opportunity to create and sustain prosperity and well-being for its people.

Voters in Greece, France and the UK have sent a clear signal in the past week that they want governments to give priority to jobs and opportunities as well as reducing deficits and debt. Prolonged stagnation or recession not only wastes resources now and deeply damages the skills of the next generation, but it may also produce dangerous political instability.

I speak today as someone who has worked on public finances, public policy and economic growth all my professional life, as an academic at the LSE and elsewhere, Chief Economist of the EBRD and of the World Bank, and a senior official at the UK Treasury. I take fiscal responsibility very seriously. We must start with 3 basic economic realities: 1) fiscal responsibility and growth are inseparable – the absence of one undermines the other, 2) an attempt at a consumption-led recovery will not be credible, 3) structural reform is essential for increasing productivity and competitiveness but takes time.

Although domestic consumption in most Member States is weak, many companies have significant savings and strong credit positions. But to invest they require confidence not only in the future of the sectors they invest in but also in the public policies that are associated with them. The low-carbon sector is the only credible growth story over the next few decades. It offers the prospect of intense creativity and innovation which can deliver an attractive and prosperous future not just for Europe, but the world as a whole.

The high-carbon path leads to huge risks of potentially catastrophic societal and economic consequences from climate change. We know we must act now to manage these risks even as we deal with the current economic crisis; delay, as the IEA and IPCC have demonstrated very clearly is dangerous. In order to have a reasonable chance of avoiding global warming of more than 2°C, global emissions will have to be reduced from the current level of 50 billion tonnes $CO_2$e per year today to less than 20 billion tonnes in 2050, and average global per capita emissions will have to fall from about 7 tonnes per head to around 2 tonnes. That means that over the next four decades, assuming the long-term trends in growth that can come from sound management, we will have to cut emissions per unit of output by a factor of about 7 or 8 in order to reduce absolute global emissions by a factor of at least 2.5.

Such a goal can be achieved only through a radical economic transformation, particularly in terms of how energy is generated and used. We need the rapid development and deployment of technologies that decarbonise our economies and a halt to deforestation. We can achieve big gains in the near term through existing technologies that increase energy efficiency and reduce our dependence on 'dirty' fossil fuels, particularly coal. Natural gas can hasten the transition and may have a role to play in the medium term if carbon capture and storage can be made to work on a commercial scale.

But to achieve the necessary reduction in emissions over the next four decades, the European Union must act to accelerate the pace of progress across the Member States. Past industrial revolutions teach us that investment flows to pioneers.

Private investment will drive this low-carbon industrial revolution as long as policy-makers show the way through clear and credible policies to tackle the six key market failures that are currently obstructing the advance.

First amongst these failures is the greenhouse gas externality which should be corrected through carbon pricing. Further market failures which require public policies include: research, development and deployment; networks such as electricity grids and public transport; capital markets and their management of risk; the provision of information; and the lack of pricing of co-benefits, such as cleaner, safer, and more secure economic activity, that arise from the shift to low-carbon growth, over and above the avoided risks of climate change.

Private investors are discouraged from exploiting opportunities in the low-carbon sector by the risk that national governments and Europe as a whole will fail to implement consistent policies to overcome these market failures. Policy-makers can boost investor confidence, and still exercise fiscal responsibility: through clarity and credibility in their actions they reduce policy risk. Failure to correct market failure is to distort markets.

By increasing the ambition of the European Union's target for reducing greenhouse gas emissions in 2020, to 30 per cent from 20 per cent, compared to levels in 1990, European governments can provide the impetus for a strong and steady carbon price and signal their commitment to the transformation.

Governments can also step up their support for research, development and deployment of technologies via the European Institute of Technology but also working directly with major universities and companies.

They can leverage private investment in the low-carbon sector through finance from the European Investment Bank and the European Bank for Reconstruction and Development. The involvement of those institutions itself reduces policy risks as I saw first-hand in my 6 years as Chief Economist of the EBRD in the 1990s.

Governments can embark on the upgrade of the power network across the continent, allowing electricity to be transmitted more efficiently and smartly to match supply and demand across a truly European super-grid. Let us have a grid that allows us to generate solar energy where it is

sunny, wind where it is windy, geothermal where the rocks are hot and at the same time facilitate the management of the intermittency of some renewables. For example, it could greatly assist Germany's energy transition, link Poland to southern solar, and stimulate activity in Spain.

Some of the necessary programmes, such as energy efficiency and aspects of public transport, can generate activity quickly. Others take longer but action must start now. Overall the scale could be substantial.

By offering a clear vision for the unleashing of the low-carbon economy, framed by credible and stable policies, the European Union can unlock private sector investment and usher in a period of investment, growth and opportunity, to the benefit of all. And now, more than ever, with both fiscal responsibility and growth, we need policies that can bind Europe together around the shared goal of a cleaner and more secure energy policy, just as Europe's founders focused on economic and political cohesion by beginning with coal and steel six decades ago. Sound economics and wise politics surely point in the same direction.