

Brown sunsets and green dawns in the industrial sector:  
Eco innovations, firm behavior and the European  
emission trading

Simone BORGHESI (University of Siena)\*  
Giulio CAINELLI (University of Padua)  
Massimiliano MAZZANTI (University of Ferrara)

**Abstract**

We study the driving forces behind the adoption of eco innovations (EI) in the Italian economy over 2006-2008 through empirical analyses of the new wave of Community Innovation Survey (CIS) data that covered eco innovation adoptions in different realms (energy, carbon, production, consumption, etc..). Given the shortage of studies that have empirically assessed the innovation effects of ETS at micro econometric level, we investigate whether the first phase of EU ETS (started in 2005-2006) has exerted some effects on eco innovations. We then include in a typical probit innovation function some policy stringency indicators, for the ETS sectors, to verify whether the likelihood of adopting eco innovations is stimulated among other factors by the ETS lever. We test a wide and comprehensive set of potential drivers, including internal factors (R&D), external (to the firm) factors (cooperation, networking), international drivers (foreign related relationships), and mostly important, the dynamic incentives to innovation eventually provided by the ETS implementation. Estimates show that external forces and complementarity with other management practices are particularly relevant to increase the adoption of relatively new and radical technologies: relationships with other firms and institutions, local public funding, group membership are the key factors in this sense. Training is also positively related to EI, confirming recent evidence. The role of ETS on EI seems instead to be weak, but it turns out to be significant for energy efficiency innovations and for consumption level / good related reductions of atmospheric and water emissions.

Keywords: eco innovation, industrial sectors, ETS, innovation drivers, CIS data.

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\*Contact address: Simone Borghesi, University of Siena, Faculty of Political Science, via Mattioli 10, 53100 Siena. E-mail: borghesi@unisi.it.

# 1 Introduction: environmental innovations and the EU ETS

The socio economic analysis of environmental innovations (EI) (Rennings, 2000; Krozer and Nentjes, 2006) is based on both the evolution of various empirical research directions on innovations drivers and on the theoretical literature regarding the dynamics of EI and the investigation of the environmental and economic performances effects of eco innovations. The literature that studies the dynamics of eco innovation has developed on a theoretical ground on both classic research issues of environmental economics studying the static and dynamic efficiency of regulatory instruments (economic vs command and control, fiscal tools and emission trading), thus including the effects of (technological, mainly emission abatement tools) innovation spurred by the regulatory stimulus (Hahn and Stavins, 1994; Goulder and Parry, 2008), and on more recent analyses evolving within evolutionary economics (Mulder and Van den Bergh, 2001), intrinsically focused on the co-evolution of innovation, policy and economic dynamics in socio-bio-economic systems (Kemp, 1997). The structural theme of innovation endogeneity is crucial and links the analysis of innovation drivers to the realm of the effects of innovations (Pizer and Popp, 2009). The empirical literature is fed by the theoretical reasoning in testing the hypotheses on efficiency (but also effectiveness in a less mainstream perspective of ex post evaluation, Millock and Nauges, 2006; Bruvoll et al., 2003) of economic and policy drivers (Johnstone, 2007). The theoretical paradigm is based on both mainstream and heterodox approaches (van den Bergh, 2007). The motivations of eco innovations (Sternier and Turnheim, 2008; Mazzanti and Zoboli, 2009b; Horbach, 2009; Rennings et al., 2003; Frondel et al. 2004), but also the complementarity nexus between drivers (Mohnen and Roller, 2005; Mazzanti and Zoboli, 2008) with other organisational innovations of environmental nature, such as EMS/auditing schemes (Harrington et al., 2007; Arimura et al., 2008; Frondel et al. 2004; Wagner, 2007, 2008; Johnstone and Labonne, 2009) are studied. On the level of economic and environmental performances of EI, the starting point is the well known Porter hypothesis (Porter and Van der Linde, 1995) on the competitive advantages that may derive in the long run from investments in eco innovations (that may anticipate or being just compliant with policies) or more in general from strategies which are not (only) based on cost reduction management options, but are aimed at investing on firm assets following the paradigm of corporate social responsibility (CSR, Reinhardt F. Stavins R: Vietor R., 2008; Margolis et al. 2007). Key factors are techno organisational innovations, training/human capital, workers and unions involvement in strategic innovative decisions, workers conditions regarding health, safety and stress. The aim is one of increasing long term profitability by means of complementary investments in technological and human capital, and the production of impure public goods linked to innovation processes (Kotchen, 2005; Rubbelke and Markandya, 2008). Environmental performances and workers conditions

are thus characterized as the public components of such investments in goods with mixed private and public feature, driven by both the rents associated to the private element and by the eventual policy stimulus tackling the public value/objective. Profit based and public objectives are brought together and strictly intertwined. The investigation of effects and relationships of EIs with the socio economic objectives internal and external to firm boundaries is a key aspect in current research directions (Mazzanti and Zoboli, 2009). Higher value of research emerges if one jointly studies innovation drivers and innovation effects, often addressed separately. On empirical grounds, a robust dynamic and integrated reasoning is possible by exploiting panel data or diachronic (lagged) cross section data.

As far as contents are concerned, research values may today emerge if one addresses the various (and new) aspects that regard the synergy and integration of circumscribed analyses of eco innovations with a larger conceptual scenario (Mazzanti and Montini, 2010). The issues and not yet tested hypotheses emerging in the literature are many (Del Rio, 2009; Van den Bergh, 2007) and contribute to define a value added for eco innovation analyses (effects and driving forces). Among the others, we list the most fruitful. A key element that has not been fully touched is the relationship between eco innovation adoptions and the status of workers conditions in a firm, an issue that links labour and environmental economics. It deserves attention since it links two of the main social benefits a CSR firm may produce: environmental public goods and benefits for workers/citizens of a territory, in addition to its core targets of profitability, productivity (Mazzanti and Zoboli, 2009a, b). Then, it creates a bridge between external public (local and global) benefits of eco innovations (lower emissions, higher energy efficiency, lower material flows) and ‘internal’ public benefits, such as health and safety in workers conditions.

The empirical studies that have investigated the drivers of eco innovations (Horbach, 2008; Horbach and Oltra, 2010) have mostly reasoned around the internal and external – to the firm – factors that can trigger EI in national or regional systems, where external factors range from cooperative behaviour to the internalisation structure and relationships of the organization (Cainelli et al., 2011a). Another bulk of the literature has focused on the co-causative relationships and complementarities among various typologies of eco-innovations (techno, EMS, ISO, etc..) and between EI and other types of EI (Ziegler and Nogareda, 2009; Wagner, 2008, 2007, 2009, 2003; Mazzanti and Zoboli, 2008; Cainelli et al., 2011b). Some new studies that use (German) EI data have very recently tried to assess the long run policy effects (Rennings and Rexhauser, 2010). The innovation effects of ETS, though extensively analysed and compared to other environmental policies at theoretical level as briefly discussed above (see also Carraro et al., 2010), have not found robust empirical testing even in relation to the first pilot phase 2005-2007. Borghesi (2010) conceptually touches upon the innovation effects of ETS in his description of ETS allocation and functioning in the past, current and future scenarios. Kemp (2010) and Kemp and Pontoglio (2007) includes some reflections on ETS innovation effects in their EI related works. A lack of empirical effort is also highlighted in

such studies, largely due to lack of firm level data on both innovation and policy sides. Truly, the past years witnessed the appearance of some micro based study that counterbalanced the prevalence of macro based simulation studies focusing on carbon pricing and its economic and environmental effects (Alberola et al., 2009, 2008; Tole, 2011). Taschini (2011) is a noteworthy example of a theoretical study that addresses the technological adoption features of ETS development, though it still relies on simulation analysis. On the other side of the literature – case sector studies based on interviews to managers and firms – we note the two studies by Pontoglio (2010) on the paper and card board sector in Italy, which finds weak if not negligible ETS effect on EI, and the study on some German sectors by Rogge et al. (2011). They find that ‘the innovation impact of the EU ETS has remained limited so far because of the scheme’s initial lack of stringency and predictability and the relatively greater importance of context factors. Additionally, the impact varies significantly across technologies, firms, and innovation dimensions and is most pronounced for R&D on carbon capture technologies and organizational changes. Our analysis suggests that the EU ETS on its own may not provide sufficient incentives for fundamental changes in corporate innovation activities at a level which ensures political long-term targets can be achieved’. In a similar study based on 42 business interviews to the Germany power sector companies, Rogge and Hoffmann (2010) find that the EU ETS mainly affects the rate and direction of technological change of power generation technologies within the large-scale, coal-based power generation technological regime, to which carbon capture technologies are added as a new technological trajectory’. Schmidt et al. (2010) also study through business surveys the innovation effects of ETS in the EU power sector, concluding that ‘the EU ETS has limited effect on the innovation activities (adoption and R&D) of both users and producers of power generation technologies. However, the perception of long-term GHG reduction targets has a significant influence on all innovation dimensions’. The innovation effects, if we look at the specific features of the EU ETS in its first phase, seem to be low.

What it lacks in the literature is nevertheless a robust econometric exercise on a relevant EU industry. Italy is major industrial country that can offer such possibility. Compared to case studies, econometrics can complementary tell us whether an empirical regularity exists, once one has controlled for various (size, sectoral) factors and the multiple drivers of EI<sup>1</sup>.

The main objectives of the paper are to analyse the new release of CIS innovation data that hosts eco innovation for Italy, and consequently assess eco innovation drivers in a wide definition of possible internal, external to the firm

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<sup>1</sup>The study by Rogge et al. (2011) opens the way to our analysis in its conclusions that are worth reporting (As we focused our analysis on the power sector, other studies will have to identify whether and how the innovation impact of the EU ETS differs across sectors. Additionally, all of our case companies were based in Germany – though often with international operations – so it might be useful to investigate whether companies with other home markets have reacted similarly to the EU ETS [...]. Finally, while our qualitative approach enabled us to study the complex causal links and feedback loops of innovation processes in the power sector and how the EU ETS is impacting them, innovation surveys allowing for statistical generalisations should complement this analysis).

and policy related drivers. We specifically aim at assessing the innovation effects of ETS, thus implicitly highlighting policy but also sector specific EI effects. We test the ETS effect with specific reference to the start up phase, that is the effect of the 2005 allocation of quotas on the adoption of EI over 2006-2008, the period of the fifth CIS. Doing this, we could also capture some anticipatory behavior by some firms and sectors, given that the ETS proposal for a Directive and the Directive itself date back to 2002 and 2003. In terms of methodology, we set up a theoretical evolutionary model that analyses the innovation choice of firms / sectors. This is the conceptual reference for the investigation of EI as a phenomenon driven by firm behaviour and policy levers. To assess the role of policies (ETS), we then construct some environmental policy indexes at sector level (policy stringency), by using data derived from the 2005 allocation of ETS quotas by the Ministry of the environment and emissions data derived from the NAMEA source (Istat hybrid economic environmental accounting). The allocation procedure left space to national states as far as sector quota allocation was concerned in the first phase (Clò, 2008; Woerdman et al 2008). This caused different stringency depending mainly on the allocated quota and the historical emission level associated to sectors. On that conceptual basis, we then analyse by probit and two stages Heckman model the probability that ETS triggered eco innovation in 2006-2008.

The paper thus contributes to the literature dealing with eco innovation drivers, using for the first time eco innovation data at national level for testing the innovation effects of ETS policy. The paper is structured as follows. Paragraph 2 sketches a theoretical model that depicts the innovation choice of firms between green and brown options. Paragraph 3 explains the rationale behind the construction of policy stringency ETS related indicators. Paragraph 4 presents the econometric analyses of eco innovation using CIS 2006-2008 data. Paragraph 5 contains some concluding remarks on the main results that emerge from the analysis.

## 2 The theoretical model

Let us consider a population of firms whose number is normalised to 1. Each firm has to choose whether: (i) to use an old, polluting technology and buy the corresponding pollution permits that are needed for its economic activity or (ii) to shift to a new, environmental-friendly technology that requires no pollution permits to operate. Let us assume, for the sake of simplicity, that the firm's output and revenues  $R$  remain unchanged whatever the adopted technology. Stated differently, we assume that in the present context eco-innovation consists of a cleaner process technology which does not imply higher production efficiency (i.e. higher output per unit of input). Finally, let us assume that the cost of the new, non polluting technology ( $c_{NP}$ ) is higher than the cost of the old, polluting technology ( $c_P$ ):

$$c_{NP} > c_P > 0$$

Each firm has, therefore, to choose between two alternative strategies:

- 1) keep on using the old technology and buy pollution permits
- 2) invest in the innovation technology which implies higher costs but sets the firm free from having to purchase the pollution permits.

Let the variable  $x(t)$  denote the share of firms choosing strategy 1 (i.e. that purchase pollution permits) at time  $t$ ,  $0 \leq x(t) \leq 1$ .

Indicating with  $\pi_k$   $k = 1, 2$  the correspondent pay-offs, we have:

$$\pi_1 = R - c_P - P_p(x)Q_P$$

$$\pi_2 = R - c_{NP}$$

where:  $P_p(x)$  indicates the price of the pollution permits, which is a strictly increasing function of the number of firms that demand them, and  $Q_P$  denotes the quantity of permits purchased by the firm that keeps using the old technology.

The process of adopting strategies is modelled by the so called *replicator dynamics* (Weibull, 1995), according to which the strategy whose expected pay-offs are greater than the average payoff spread within the populations at the expense of the alternative strategy:

$$\dot{x} = x(\pi_1 - \bar{\pi})$$

where

$$\bar{\pi} = x \cdot \pi_1 + (1 - x) \cdot \pi_2$$

is the average payoff of the population of firms.

From the equations above, it turns out that the replication dynamics can be written as follows:

$$\dot{x} = x(1 - x)(\pi_1 - \pi_2) = x(1 - x)[c_{NP} - c_P - P_p(x)Q_P]$$

Notice that if  $[c_{NP} - c_P - P_p(x)Q_P] > 0$ , then the payoff of strategy 1 is higher than that of strategy 2, so that a higher number of firms will decide to keep on using the old technology ( $\dot{x} > 0$ ). This will increase in its turn the price of pollution permits, thus reducing the gap between the payoffs of the two strategies. If, on the contrary,  $[c_{NP} - c_P - P_p(x)Q_P] < 0$ , strategy 2 is more remunerative than strategy 1. In this case, therefore, a higher number of firms will shift towards the innovative technology ( $\dot{x} < 0$ ), which decreases the pollution price. The process will go on as long as  $[c_{NP} - c_P - P_p(x)Q_P] < 0$  until the term between brackets get to zero, so that each firm is indifferent between the two alternative strategies.

From the replication dynamics above, it follows that three possible equilibria can occur in the model, namely the two extreme steady states:

- (i)  $x = 0$  in which all firms adopt the innovative technology
- (ii)  $x = 1$  in which no firm adopts the innovative technology

and an internal equilibrium in which some firms adopt the new technology while others keep on using the old technology. More precisely, the latter case will occur if:

$$(iii) \exists x^* \text{ such that } c_{NP} - c_P = P_p(x^*)Q_P$$

Observe that the internal equilibrium  $x^*$  is a sink (attractor), while the two extreme equilibria  $x = 0$  and  $x = 1$  are sources (repellers). As a matter of fact, as it can easily be verified:

$$\text{if } 0 < x < x^* \text{ then } \dot{x} > 0, \text{ while } x > x^* \text{ we have } \dot{x} < 0.$$

It follows that, whatever the initial share of firms that buy the pollution permits, the system will always converge towards the stable internal equilibrium  $x^*$ .

The simple analytical framework proposed above can be easily extended to examine the innovation choices performed at the sector level. Consider, for instance, a generic sector  $i$  that is included in the EU-ETS. The dynamics of the permits demand (i.e. the share of firms that purchase permits) in sector  $i$  will be given by:

$$\dot{x}_i = x_i(1 - x_i) (\pi_{1i} - \pi_{2i}) = x_i(1 - x_i) \left[ c_{NP,i} - c_{P,i} - P_p(x_i + \sum_{j \neq i} x_j)Q_{p,i} \right]$$

where index  $j$  denotes any other sector regulated by the ETS legislation beyond sector  $i$ .

Notice that while the innovation process is sector-specific, the permit price is common to all the ETS sectors, therefore it is influenced by the aggregate demand of all the firms operating in all sectors involved in the ETS.

Indicating with  $\Delta c_i = c_{NP,i} - c_{P,i}$  the differential cost between the new and the old technology in sector  $i$  and assuming that all firms have a linear inverse demand function for pollution permits, there exists an inner equilibrium  $x^* = (x_i^*, x_j^*) \in \mathbb{R}_{++}$  such that:

$$\frac{\Delta c_i}{Q_{P,i}} = \frac{\Delta c_j}{Q_{P,j}} \quad \forall j \neq i$$

In the following we use the model as a reference to test the ETS effect on (sector) innovation. Next section is devoted to the explanation of how to set up sound ETS sector specific stringency indicators.

### 3 ETS stringency indicators

We construct a series of ETS policy indicators that are aimed at capturing the stringency of the policy in its first allocation phase. We exploit two main

sources of information: the NAMEA sector emission data (Tudini and Vetrella, 2011) released by ISTAT (over 1990-2008, we exploit 2000-2005 data) and the information on the allocation decision provided by official documents of the Italian ministry of the environment (Ministero dell'ambiente, 2006).

Our measures of stringency are basically two, with some ancillary modifications that in both cases are aimed at implementing a sensitivity analysis. The use of multiple indexes is in any case a way to carry out a sensitivity analysis. The two indicators tell the same story from a slightly different perspective.

The first indicator is the following:

$$s_1 = T * s_i - EUA_i$$

where  $EUA_i$  = tradable permits (European Union Allowances) of sector  $i$ ;  $T$  = national emission target (Kyoto target: given that we use 2005 as pivotal year, we have weighted the Italian -6.5% reduction accordingly, thus taking in the calculation 2/3 of the total target of Italy;  $s_i = e_i / \sum e_j$  = emission share of sector  $i$ ;  $e_i$  = emissions of sector  $i$ ;  $\sum e_j$  = total emissions

The second indicator that can be used as an alternative to the first one is the following:

$$s_2 = e_i / EUA_i$$

To highlight the connection between the indicators  $s_1$  and  $s_2$ , notice that the former may also be rewritten as follows:

$$s_{1bis} = [T * s_2 * EUA_i] / \sum e_j - EUA_i \text{ or, equivalently,}$$

$$s_{1bis} = EUA_i [(T * s_2) / \sum e_j - 1]$$

As far as  $s_2$  is concerned, we have constructed three alternatives: (i) 2005 NAMEA emissions / allocated quotas, (ii) 2000-2005 average NAMEA emissions / allocated quotas (iii) Ministry of the environment reported 2000 emissions / allocated quotas; (i) is chosen as main indicator.

Concerning  $s_1$ , we have defined a version taking 2005 as benchmark year for the Kyoto target (2/3 of total reduction) and a version with the proper final Kyoto target of -6.5%.

Then,  $s_{1bis}$  was also calculated taking both NAMEA 2000-2005 average emissions and the Ministry of the environment emissions.

In the econometric analysis that follows we will run regressions using a dummy variable that takes value 1 for sectors under the ETS (DE1 – paper and cardboard without printing branch; DF, DI, DJ) and value 0 for all other sectors. When the dummy takes value 1, we then compute stringency indicators mentioned above. The use of both the ETS dummy and the stringency indicators among the EI regressors allows to distinguish the impact on the EI deriving from the presence of the ETS from the effect generated by the stringency of the regulation. The values of all stringency indicators by sector are available upon request.

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<sup>1</sup>One can reasonably expect that the most polluting sectors show the highest stringency indicators. This seems to be confirmed by the available data: as a matter of fact, the most polluting sector (DI) is besides one case the sector that presents the most stringent allocation in our dataset.



## 4 The empirical framework

### 4.1 The data and the model

In order to analyse the drivers of EI in the Italian manufacturing industry and test the innovation effect of ETS, we exploit three sources of data. The main source is represented by the CIS dataset (5th wave), that for the first time covers eco innovation adoptions, coherently with the definition of EI developed by the Measuring eco innovation (MEI) project funded by the EU 6th Framework programme (Kemp, 2010). Descriptive statistics on the sample of firms (6,843 firms in total) and on the distribution of EI by dimensional class and sector are available upon request.<sup>2</sup> A similar (CIS like) survey on EI and other innovation practices for the Emilia Romagna, a strongly industrialised region of Italy is used in Cainelli et al. (2011a, b). In what follows we will highlight similarities between the two set of results when sound.

In addition, in order to set up the ETS policy stringency indicator, we exploit two additional sources, as also indicated above: the NAMEA emissions (2005, and 2000-2005 to capture medium run trend) and the Italian allocation of ETS quotas by sector. Those two sources of sector data are merged with firm data. In absence of firm data this procedure is quite standard, as in Cole et al. (2009), who merge wage individual data and firm pollution data, and Cainelli et al. (2010). Cluster correction is needed in such cases.

We use dprobit as our estimator tool to study the probability of adoption, given that our EI variables are specified as dichotomous indexes. Dprobit fits with maximum-likelihood probit models and is an alternative to probit. Rather than reporting the coefficients, dprobit reports the marginal effects, that is, the changes in the probability of an infinitesimal change in each independent, continuous variable and, by default, reports the discrete changes in the probability for the dummy variables. Table 1 provides a brief explanation for the main factors tested. The full descriptive statistics are available upon request.

Our econometric model is based on the following probit specification:

$$\Pr(Y_i = 1/X) = \Phi(X'\beta)$$

where  $\Phi$  is the cumulative distribution function of the standard normal distribution and  $Y_i$  is a dummy variable taking the value 1 if firm  $i$  introduces an environmental innovation and 0 otherwise.  $X$  is the set of covariates described in table 1.

### 4.2 Econometric evidence

We present results for the EI drivers first focusing on EI related to ‘material per unit of output’, ‘reduction of CO2 emissions’ and ‘energy use per unit of output’ (benefits on the production phase). This is the main level at which

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<sup>2</sup>We thank ISTAT for the provision of data and the possibility to have access to original sources to carry out estimates.

we test the hypothesis that ETS stringency can eventually lead to innovation effects, with a special interest on the second and third specifications, given that ETS is devoted to reduce carbon dioxide through abatement technologies and/or energy reprocessing and changes to energy structure. Second, we also exploit the EI information on technology adoptions that reduce impacts at the level of ‘use of goods’: ‘reduction of energy consumption’, ‘reduction of emissions and water and soil pollution’, ‘Material, waste, water recycling’. The extension to the second use oriented perspective is in line with a life cycle approach that does not focus only on production but takes a ‘from cradle to grave’ view of EI and environmental performances.

#### 4.2.1 *Environmental innovations that produce benefits at production level*

Tables 2 and 3 present outcomes for the ‘production side’ of EI benefits, where 3 dependent variables are utilised. We comment on internal, external to the firm and policy correlated factors, including ETS policy stringency.

As far as ‘internal sources’ are concerned, we note that R&D expenditures are never significant (confirming results obtained by Cainelli et al. 2011a, b and Horbach and Oltra, 2010). Specific environmental R&D is probably needed, whereas the lack of significance of R&D is in our eyes related to the fact that R&D ends up with being in essence a proxy for absorptive capacity<sup>3</sup>. Training activities are instead positively correlated to EI, with a peak of statistical significance in the case of energy efficiency. This result is coherent with the strong link between EI and training coverage that was also found for Emilia Romagna firms in Cainelli et al. (2011a, b)<sup>4</sup>. Then, also productivity (in 2006) is as expected a determinant of innovation in the following period. This evidence reconfirms that virtuous circles exist: environmental innovations are driven by a core positive economic performance and could further contribute to enhance the economic and environmental performance of the firm.

External sources show to substantially matter in the way they add information on the multiple sources behind EI adoption. While the innovation oriented cooperation activities do not matter if taken in their aggregate level – further estimates could be carried out on cooperation with specific agents – a number of ‘information sources’ are relevant. Receiving information from other firms of the group is relevant for energy efficiency; this reinforces the massive relevance of being part of a group for all kind of innovations. This is extremely interesting and confirms that EI is heavily engraved in networking relationships. It extends

<sup>3</sup>As known in the evolutionary economics and innovation studies literature, R&D is often a factor embodying the innovative (absorptive) capacity, rather than a deep internal effort by the firm towards the achievement of a comprehensive and environment specific productivity enhancement. It can thus be not a determinant of more radical forms of innovation and performance (Malerba and Orsenigo, 1997).

<sup>4</sup>We note that the non significance of export is also coherent with what found by Cainelli et al. (2011a,b), who in addition highlight the role played by FDI and foreign ownership among international drivers of EI.

to EI the coordinated strategy / group effects on R&D/ process and product innovation adoptions that was found by using CIS data by Cefis et al. (2010) .

Suppliers also confirm to be relevant as source of EI (similar outcomes are found by Cainelli et al. 2011a, b). The set of agents involved behind EI is large. Information received from Universities and public institutions also appear to impact on the likelihood to adopt EI, as well as information received by attending fairs/conferences and by using the support offered by industrial association services.

It is highly interesting to note that the ‘information’ / relational factor are especially relevant for CO2 abatement. This is coherent with the ‘public good’ nature of CO2 that needs for abatement a sort of breakthrough technology adoptions for which internal sources of the firm are absolutely not sufficient. Private and public support is a key factor there.

Finally, the role of policy variables is examined. The ‘public’ support confirms to be a necessary part of the story to cope with CO2 externalities. In fact, firms which received public funding are more likely to adopt EI. This is especially true, as expected, for energy efficiency, and also CO2. The higher significance of energy efficiency may depend on the mixed public good nature: public support also stimulate private investments. The weak significance for CO2 alone may justify a reflection on the possibility to increase public support.

This is even truer if we look at the result for the stringency ETS dummy, which appears not relevant as EI explanatory factor. This means if we take a sectoral level perspective that the sectors under the ETS umbrella (DE1, DF, DI, DJ, see appendix) were not associated to higher EI adoptions over 2006-2008. More interestingly, the ETS continuous stringency indicator that we test in table 3 is also not relevant. Not only ETS sector do not show a substantially different EI performance with respect to other manufacturing sectors, but their ‘relative difference’ in terms of ETS stringency<sup>5</sup> did not exert any influence. EI were in the first phase of ETS still determined by firm related and mostly external to the firm factors. The evidence confirm the expectations outlined by works on the effects of EU ETS, and also sustain the case study evidence that ETS – mostly depending on its price volatility and low level – was not a major driver of EI.

We also note that this evidence tells us that such sectors, which had expectations on the allocation quotas they would receive well before 2006, did not take any type of ‘early moving’ behaviour towards EI. They probably supposed the Italian allocation would not be stringent, or not stringent enough or require innovative efforts beyond the status quo dynamics.

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<sup>5</sup>We tested all proxies identified in section 3. Indicators related to  $s_2$  were in the end most significant than others if we consider together estimates in sections 4.2.1 and 4.2.2. Estimates are nevertheless really preliminary at this stage.

#### 4.2.2 *Environmental innovations that produce benefits at consumption/use of goods level*

Tables 4 and 5 present evidence for the ‘use phase’ benefits of some EI (energy, emissions, waste and materials). Relationships with other firms in the group are still relevant, though the mere group membership appeared stronger in its relevance in the production side of the tale. Among ‘information related’ factors, suppliers and private research institutions exert some significant positive effect on EI. All in all, we may affirm that information received from other agents and the influence of business group membership is stronger for EI that exert benefits at the production level.

The evidence on internal and structural factors is basically similar to above, with the slight exception of a weak R&D significance. Training is instead confirmed a pillar associated to the EI firm strategy even in this case.

Things are different as far as policy levers are concerned. At the use/consumption level of EI, public funding is not relevant. As expected, public funding supports production reprocessing and abatement, while it is less focused on life cycle benefits of products, which is also coherent with the very low share of Italian firms that invest and adopt EMS.

We instead find both in table 4 (for EI ECOPOS and ECOREA) and table 5 (for EI ECOPOS) a significant positive effect of ETS ‘presence’, and ‘stringency’ as well. Sectors associated to ETS adopted more EI over 2006-2008 in the realms of emission reductions, and recycling of material, waste and water. Furthermore, the stronger the stringency of ETS (relatively to sectors DE, DF, DI, DJ), the higher the likelihood of adopting EI for abating pollution emissions at the use level of goods.

Contrary to expectations, ETS exert some innovative impacts not at the production level of environmental benefits but at the use / consumption level of benefits. The only case where we effectively find a very robust stringency dependant effect of ETS is nevertheless the ‘Water, soil and atmospheric emission reduction (use phase benefit)’. It is worth noting that such statistical significance of ETS is robust since it is controlled for sector, size and geographical features of the firm.

Though not directly linked to CO2 reductions, then, ETS appear to be among the significant EI correlated factors. An interpretation of this result may be that if on the one hand the stringency (including credibility) of ETS was not sufficiently high at least at the beginning of its development to stimulate specific carbon reduction technology adoptions, it triggered on the other hand cheaper, less radical and less problematic EI investments. Those EI adoptions that seem to be favoured by ETS related to use level emission and recycling. Emission abatement is in the end complementary to CO2 abatement to a great extent. Firms may start addressing the EI strategy from the ‘safe’ side, that is from innovation adoptions that are both relatively less radical – compared to energy/CO2 – and importantly that were already associated to some environmental regulations (e.g. EU CAFE for emissions, EU local regulations for emission and water, waste regulations for packaging waste deriving from EU

directives). Thus, ETS seems to have exerted effects of indirect nature and on EI already under regulation pressures. This appears to be the case of a carbon related policy that has some effects of incremental nature, in top of existing policy realms. We overall confirm the evidence provided by business surveys and case studies: in order to witness significant EI effects directly stimulated by the EU ETS, higher stringency levels and thus higher and stable prices will be needed.

## 5 Conclusions

We have attempted to provide first micro econometric evidence on the EI effects of EU ETS by exploiting newly available Italian CIS data for manufacturing firms. Building up on (i) a theoretical model that creates a simple analytical framework where to analyze the levers behind the eco innovative decision of firms in a regulated sector and (ii) the consequential construction of sector specific ETS stringency indicators, we investigate the policy induced EI effects of ETS in an usual ‘innovation function’ adoption approach. We then extend the set of (typical) EI drivers – internal and external to the firm EI correlated factors to policy stimulus. We further address problems of ‘omission of relevant variables’ by introducing a potential relevant policy lever, and in the meanwhile we control the policy effects for all structural factors characterizing the firm and all other EI levers. The eventual policy effect is then made robust.

Estimates are rich in results and present compelling evidence for EI for what concerns both policy and firm-related factors (internal and external). They show and confirm that eco innovations are driven by a set of multiple factors, internal and external to the firm. External forces seem to be mostly relevant to increase the adoption of relatively new and radical technologies. If on the one hand internal R&D does not influence EI, relationships with other firms and institutions, local public funding, group membership are the key factors. It is worth noting that a high performance practice such as training is positively related to EI, confirming recent evidence. As far as ETS is concerned, it seems that its role is weak, but significant for energy efficiency innovations (not for CO<sub>2</sub>) and for consumption level / good related reductions of atmospheric and water emissions. Eco innovations emerge and confirm to be an innovation phenomenon that is highly embedded in what the firm does outside its formal boundaries. External forces, complementarity with other management practices, and policy appear to consistently matter for its adoption in industrial firms.

Overall, the suggestions deriving from works that have addressed the EU ETS concrete role as EI driver, at least in its first phase, and the evidence offered by case studies, is confirmed by our micro econometric analysis on major industrial countries.

Further research could investigate whether the second and third phases of ETS have and will produce more intense EI adoptions. It will be challenging

to analyze the second phase of ETS that overlapped with the severe 2008-2009 recession and the post crisis fragile economic environment. As far as our work is concerned, we can affirm that though 2008 is a year within the CIS, EI were not influenced by the economic recession that appeared quite late in 2008. The economic and policy dynamics that characterized the first 5 years of the century were mostly influencing EI over 2006-2008. Further research could also try to merge Italian and other EU countries CIS to enlarge the datasets and the set of testable implications on both economic and policy grounds.

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**Table 1 – The set of variables used in the analysis**

Dependant variables (EI)	
Reduction in the use of material per unit of output (production phase benefit)	ECOMAT
Energy reduction per unit of output (production phase benefit)	ECOEN
CO <sub>2</sub> reduction (production phase benefit)	ECOCO
Energy consumption reduction (use phase benefit)	ECOENU
Water, soil and atmospheric emission reduction (use phase benefit)	ECOPOS
Material, waste, water recycling (use phase benefit)	ECOREA
Independent variables: external factors	
Information relevant for innovation received from other firms in the group <sup>1</sup>	INF-GROUP
Information relevant for innovation received from suppliers	INF- SUPP
Information relevant for innovation received from clients	INF-CLIEN
Information relevant for innovation received from competitors	INF-OTHFIR
Information relevant for innovation received from private research centres	INF-PRIVRES
Information relevant for innovation received from universities	INF-UNIV
Information relevant for innovation received from public research institutions	INF-PUBRES
Information relevant for innovation received from fairs and conferences	INF-FAIR
Information relevant for innovation received from publications/journals	INF-JOURN
Information relevant for innovation received from industrial sector associations	INF-ASSOC
Innovation related agreements with other firms and institutions	COOPERATION
Part of a business group	BUSINESS GROUP
IND. VARIABLES: INTERNAL FACTORS	
Growth of sales 2006-2008	SALE_GROWTH
2006 labour productivity level	PRODUCTIVITY
Share of exported turnover	EXPORT
R&D expenditures per employee	R&D
IND. VARIABLES: POLICY FACTORS	
Firm belonging to ETS sectors (DE, DF, DI, DJ)	D_ETTS
Stringency of ETS allocation for the sector	ETS -STRINGENCY
The firm received Innovation related public funding during 2006-2008	PUBFUND

<sup>1</sup> Dummy takes value 1 if information has high or medium relevance.

**Table 2 – EI that produce benefits in the production phase**

Covariates:	Estimation method: DPROBIT					
	<i>ECOMAT</i>		<i>ECOEN</i>		<i>Ecoco</i>	
	<i>dF/dx</i>	<i>t-value</i>	<i>dF/dx</i>	<i>t-value</i>	<i>dF/dx</i>	<i>t-value</i>
INF-GROUP	0.006	0.52	0.033**	2.29	0.0003	0.03
INF- SUPP	0.047***	4.01	0.028**	2.27	0.029***	2.59
INF-CLIEN	0.017	1.45	0.018	1.39	0.008	0.76
INF-OTHFIR	0.009	0.75	0.002	0.15	-0.018	-1.47
INF-PRIVRES	-0.015	-1.31	-0.008	-0.68	0.005	0.42
INF-UNIV	0.039*	1.93	0.005	0.25	-0.005	-0.27
INF-PUBRES	0.009	0.39	0.031	1.17	0.055**	2.19
INF-FAIR	0.024*	1.87	0.028**	1.99	0.035***	2.74
INF-JOURN	-0.019	-1.42	-0.011	-0.79	-0.025*	-1.93
INF-ASSOC	0.018	1.33	0.015	1.03	0.045***	3.15
<i>D_ETTS</i>	<i>0.019</i>	<i>0.62</i>	<i>0.053</i>	<i>1.55</i>	<i>0.032</i>	<i>1.10</i>
COOPERATION	-0.003	-0.23	0.011	0.73	0.003	0.25
TRAIN	0.020*	1.74	0.036***	2.87	0.027**	2.43
BUSINESS GROUP	0.050***	4.29	0.038***	3.05	0.029**	2.55
SALE_GROWTH	0.017	1.27	0.017	1.21	0.012	0.91
PRODUCTIVITY	0.025***	3.82	0.022***	3.08	0.024***	3.86
EXPORT	0.016	1.53	0.016	1.44	0.017*	1.69
R&D	0.001	0.12	-0.004	-0.30	0.017	1.41
PUBFUND	0.003	0.26	0.039***	2.69	0.024*	1.88
Size dummy	Yes		Yes		Yes	
Geographic dummy	Yes		Yes		Yes	
Industry dummy	Yes		Yes		Yes	
N. Obs.	6,483		6,483		6,483	
Pseudo R2	0.061		0.056		0.060	
Log pseudolikelihood	-2537.88		-2844.62		-2478.85	

\*\*\* significant at 1%; \*\* significant at 5%; \* significant at 10%



**Table 3 – EI that produce benefits in the production phase**

Covariates:	Estimation method: DPROBIT					
	<i>ECOMAT</i>		<i>ECOEN</i>		<i>ECOCO</i>	
	<i>dF/dx</i>	<i>t-value</i>	<i>dF/dx</i>	<i>t-value</i>	<i>dF/dx</i>	<i>t-value</i>
INF-GROUP	0.006	0.52	0.033**	2.29	0.0003	0.03
INF- SUPP	0.047***	4.01	0.028**	2.27	0.029***	2.59
INF-CLIEN	0.017	1.45	0.018	1.39	0.008	0.76
INF-OTHFIR	0.009	0.75	0.002	0.15	-0.018	-1.47
INF-PRIVRES	-0.015	-1.31	-0.008	-0.68	0.005	0.42
INF-UNIV	0.039**	1.93	0.005	0.25	-0.005	-0.27
INF-PUBRES	0.009	0.39	0.031	1.17	0.055**	2.19
INF-FAIR	0.024*	1.87	0.020**	1.99	0.035***	2.74
INF-JOURN	-0.019	-1.42	-0.011	-0.79	-0.025*	-1.93
INF-ASSOC	0.018	1.33	0.015	1.03	0.045***	3.15
<i>ETS STRINGENCY</i>	<i>-0.016</i>	<i>-1.35</i>	<i>0.004</i>	<i>0.32</i>	<i>-0.006</i>	<i>-0.54</i>
COOPERATION	-0.003	-0.23	0.011	0.73	0.003	0.25
TRAIN	0.020*	1.74	0.036***	2.87	0.027**	2.43
BUSINESS GROUP	0.050***	4.29	0.038***	3.05	0.029**	2.55
SALE_GROWTH	0.017	1.27	0.017	1.21	0.012	0.91
PRODUCTIVITY	0.025***	3.82	0.022***	3.08	0.024***	3.86
EXPORT	0.016	1.53	0.016	1.44	0.017*	1.69
R&D	0.001	0.12	-0.004	-0.30	0.017	1.41
PUBFUND	0.003	0.26	0.039***	2.69	0.024*	1.88
Size dummy	Yes		Yes		Yes	
Geographic dummy	Yes		Yes		Yes	
Industry dummy	Yes		Yes		Yes	
N. Obs.	6,483		6,483		6,483	
Pseudo R2	0.061		0.056		0.060	
Log pseudolikelihood	-2537.88		-2844.62		-2478.85	

\*\*\* significant at 1%; \*\* significant at 5%; \* significant at 10%

**Table 4 – EI that produce benefits in the consumption/use phase**

Covariates:	Estimation method: DPROBIT					
	<i>ECOENU</i>		<i>ECOPOS</i>		<i>ECOREA</i>	
	<i>dF/dx</i>	<i>t-value</i>	<i>dF/dx</i>	<i>t-value</i>	<i>dF/dx</i>	<i>t-value</i>
INF-GROUP	0.048***	3.07	0.050***	3.11	0.039***	2.56
INF- SUPP	0.027**	1.97	0.005	0.37	0.026**	1.98
INF-CLIEN	0.024*	1.76	0.022	1.55	0.007	0.57
INF-OTHFIR	0.006	0.42	0.033**	2.06	0.022	1.49
INF-PRIVRES	0.031**	2.21	0.033**	2.23	0.053***	3.72
INF-UNIV	0.030	1.31	0.026	1.06	0.013	0.60
INF-PUBRES	-0.003	-0.12	0.005	0.17	0.028	1.00
INF-FAIR	0.015	1.05	0.024	1.54	0.031**	2.09
INF-JOURN	0.017	1.02	0.019	1.10	-0.003	-0.24
INF-ASSOC	0.02	1.37	0.026	1.54	0.027	1.64
<i>D_ETTS</i>	<i>0.013</i>	<i>0.38</i>	<i>0.078**</i>	<i>2.05</i>	<i>0.069**</i>	<i>2.00</i>
COOPERATION	0.004	0.27	0.016	0.89	0.006	0.37
TRAIN	0.033**	2.47	0.035**	2.54	0.026**	1.99
BUSINESS GROUP	0.020	1.51	0.009	0.68	0.028**	2.11
SALE_GROWTH	-0.013	-0.84	0.009	0.58	0.001	0.09
PRODUCTIVITY	0.026***	3.42	0.019**	2.35	0.014*	1.94
EXPORT	0.018	1.47	-0.002	-0.17	0.008	0.70
R&D	0.027*	1.84	0.027*	1.79	0.013	0.92
PUBFUND	0.012	0.80	-0.001	-0.08	-0.001	-0.10
Size dummy	Yes		Yes		Yes	
Geographic dummy	Yes		Yes		Yes	
Industry dummy	Yes		Yes		Yes	
N. Obs.	6,483		6,483		6,483	
Pseudo R2	0.110		0.095		0.061	
Log pseudolikelihood	-3015.03		-3180.27		-3029.50	

\*\*\* significant at 1%; \*\* significant at 5%; \* significant at 10%

**Table 5 – EI that produce benefits in the consumption/use phase**

Covariates:	Estimation method: DPROBIT					
	<i>ECOENU</i>		<i>ECOPOS</i>		<i>ECOREA</i>	
	<i>dF/dx</i>	<i>t-value</i>	<i>dF/dx</i>	<i>t-value</i>	<i>dF/dx</i>	<i>t-value</i>
INF-GROUP	0.048***	3.07	0.050***	3.11	0.039***	2.56
INF- SUPP	0.027**	1.97	0.005	0.37	0.026**	1.98
INF-CLIEN	0.024*	1.76	0.022	1.55	0.007	0.57
INF-OTHFIR	0.006	0.42	0.033**	2.06	0.022	1.49
INF-PRIVRES	0.031**	2.21	0.033**	2.23	0.053***	3.72
INF-UNIV	0.030	1.31	0.026	1.06	0.013	0.60
INF-PUBRES	-0.003	-0.12	0.005	0.17	0.028	1.00
INF-FAIR	0.015	1.05	0.024	1.54	0.031**	2.09
INF-JOURN	0.017	1.02	0.019	1.10	-0.003	-0.24
INF-ASSOC	0.022	1.37	0.026	1.54	0.027	1.64
<i>ETS STRINGENCY</i>	<i>0.002</i>	<i>0.17</i>	<i>0.041***</i>	<i>3.02</i>	<i>0.002</i>	<i>0.17</i>
COOPERATION	0.004	0.27	0.016	0.89	0.006	0.37
TRAIN	0.033**	2.47	0.035**	2.54	0.026**	1.99
BUSINESS GROUP	0.020	1.51	0.009	0.68	0.028**	2.11
SALE_GROWTH	-0.013	-0.84	0.009	0.58	0.001	0.09
PRODUCTIVITY	0.026***	3.42	0.019**	2.35	0.014*	1.94
EXPORT	0.018	1.47	-0.002	-0.17	0.008	0.70
R&D	0.027*	1.84	0.027*	1.79	0.013	0.92
PUBFUND	0.012	0.80	-0.001	-0.08	-0.001	-0.10
Size dummy	Yes		Yes		Yes	
Geographic dummy	Yes		Yes		Yes	
Industry dummy	Yes		Yes		Yes	
N. Obs.	6,483		6,483		6,483	
Pseudo R2	0.110		0.095		0.061	
Log pseudolikelihood	-3015.03		-3180.27		-3029.50	

\*\*\* significant at 1%; \*\* significant at 5%; \* significant at 10%

## Appendix

Table A.1 – Classification of manufacturing activities

Codes	Description
DA	Food products, beverages and tobacco
DB	Textile and clothing
DC	Leather and leather products
DD	Wood and wood products
DE	Pulp, paper, and paper products, publishing and printing
DF	Coke, refined petroleum products, and nuclear fuel
DG	Chemicals, chemical products, and man-made fibres
DH	Rubber and plastic products
DI	Non-metallic mineral products
DJ	Basic metals and fabricated metal products
DK	Machinery and equipment
DL	Electrical and optical equipment
DM	Transport equipment
DN	Other manufacturing