BLOG

Sustainable finance: a road towards a climate neutral Europe

29 Oct 2019 – Climate

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Successful climate change mitigation and adaptation require not only the right type of incentives and technology but also investments. A key question in sustainable finance is finding ways for reorienting investments more rapidly and effectively, but at the same time in a balanced manner, towards supporting emission reduction targets.

In the European Union, greenhouse gas (GHG) emissions have been slow to decrease, despite an increasing flow of funds into environmentally sustainable investments. Despite the upward trend, sustainable investments are, in euro terms, still not very significant compared with traditional investments. Moreover, despite the possible successes in the reduction of emissions from *production*, the situation regarding *consumption*-based emissions is often not as positive.

The European Commission published in spring 2018 an Action Plan on financing sustainable growth. To achieve the EU's climate and energy targets for 2030, i.e. a 40%

cut in greenhouse gas (GHG) emissions compared with 1990, and thus the level of GHG emissions required by the Paris Agreement on Climate Change, the EU has to close an annual investment gap of EUR 180 billion. And if we take into consideration the possible tightening of climate targets in the future, the actual investment gap is much larger.

Sustainable investments would be desirable not only from the perspective of the climate targets but also for economic growth. They would support economic growth and possibly even improve productivity in Europe. The effects of climate change usually hit hardest those who are the most vulnerable, and therefore climate action would also be a socially sound investment.

Increasing climate change mitigation investments and ecologically sustainable investments may require a carrot and stick approach. The key measures for achieving this objective are cutting the current subsidies for fossil fuels and putting a global price on emissions. In practice, the latter would mean a global carbon tax or emissions trading system. To ensure a just transition, we should also consider ways of levelling the costs of transition to carbon neutrality.

One of the first objectives of the new European Commission is to put forward a European Green Deal. The European Green Deal proposes, for example, extensions to the Emissions Trading System and the introduction of a Carbon Border Tax to avoid carbon leakage. Carbon pricing in the EU would thus not result in the shifting of polluting activity to countries outside the EU, as the same costs would be applied on products imported to Europe. The Commission also proposes a new Just Transition Fund, to support the regions that are most affected by the transition. Undoubtedly, these are all difficult issues politically, but they are so important that we cannot afford not to take action.

Financing green investment will also require suitable instruments on the financial markets. The EU is currently the most significant economy in the issuance of green bonds. A growing number of global investors wish to purchase green bonds, even to the extent that the global supply of these types of bonds is lower than the demand. A significant challenge in the purchase of green bonds is the variety of standards. Neither investors nor issuers often benefit from this many alternatives.

In addition to green bonds, various types of green and other ESG (Environment, Social & Governance) linked loans and bonds have become increasingly popular in the EU. For example, a bank can grant a company a loan whose interest rate is tied to the company's climate performance, for example the reduction of emissions. These products, too, do not yet have standards; they all are tailored products.

Lack of harmonisation may slow the introduction of instruments for sustainable finance. Appropriately harmonised products could decrease the costs of issuance and increase investor confidence in the products. Currently, however, there are no indications on the markets of a transition towards harmonised practices.

Positive developments could be supported by a stronger role for the authorities as a catalyst for the creation of harmonised practices and instruments. Sustainable finance would contribute to achievement of the EU's climate targets, while at same time fostering the integration of the Union's capital markets. This double benefit should be taken into consideration in defining the EU's future priorities as the new European Commission starts its work. At the same time, it would speed up the Union's transition to a climate neutral economy by the agreed date.

Tags

sustainable finance, consumption, production, climate change, investment