

CLIMATE REPORT 2017

PRIVATE SECTOR AND CLIMATE FINANCE IN THE G20 COUNTRIES

ABOUT THE REPORT

The G20 countries comprise two thirds of the global population as well as more than three quarters of the world's economic output, trade and CO₂ emissions. Climate change is on the G20 agenda as a central future issue, also as an economic and fiscal challenge because corresponding investments from the private sector are a prerequisite for the fulfilment of the Paris climate protection goals. Our latest Climate Report, which continues the series from 2007, 2011 and 2014, provides answers to the question of how far the private sector plays a role in climate financing in the G20 countries.

FRANCE

France has made extremely ambitious commitments in connection with the reduction of greenhouse gas emissions. The French finance ministry predicts short-term investment needs till the year 2020 of between 40 to 60 billion euros annually. However, in its present form, the climate finance regulation in France depicts rather a brake for investments on account of the regulatory rules provided. The determination of a significant CO₂ price could accelerate the redirection of private finance in the direction of low CO₂ investments.



*The General Electric offshore wind turbine plant in Montoir-de-Bretagne, near Saint-Nazaire, in western France.
Source: © Stephane Mahe, Reuters*

THE ROLE OF PRIVATE FINANCING FOR CLIMATE PROTECTION

In the 2015 “Energy Transition for Green Growth” Act, there is a provision for reducing the emission of greenhouse gases in France by 75 percent (default value from 1990). During the COP 22 in Marrakech, the French President tightened this ambitious goal further as he announced the same time-frame of emission neutrality for France. The challenge is enormous and requires a massive redirection of investment and the corresponding finances towards solutions without carbon in order to produce energy, ensure traffic mobility and provide accommodation and nourishment.

The French finance ministry predicts short-term investment needs till the year 2020 of between 40 to 60 billion euros annually. This funding framework corresponds to between ten and 15 percent of total investment in France. In its 2015 panorama of climate financing, the Think Tank 14CE (*Caisse des Dépôts* and AFD) mentions an estimated annual volume of 32 billion euros for France; 12.8 billion for energy efficiency, 6.5 billion for renewable energies (EE), 10.6 billion for the construction and modernization of sustainable transport and network infrastructure as well as 2.1 billion for the rehabilitation of nuclear power plants (KKW) and the war against other greenhouse gases (THG). 40 percent of this finance is provided by the state, business enterprises and households bear another 30 percent each.

If France wants to fulfil the assumed commitments, it would have to invest around 15 billion euros more annually till 2020 (around ten billion alone would be for the energy efficient rehabilitation of buildings). The additional need for finance is however quite modest and above all it involves redirecting private investments: less for fossil fuel energy sources and energy production capacities and more for renewable energies and energy efficiency. Also, if private finances do not flow in

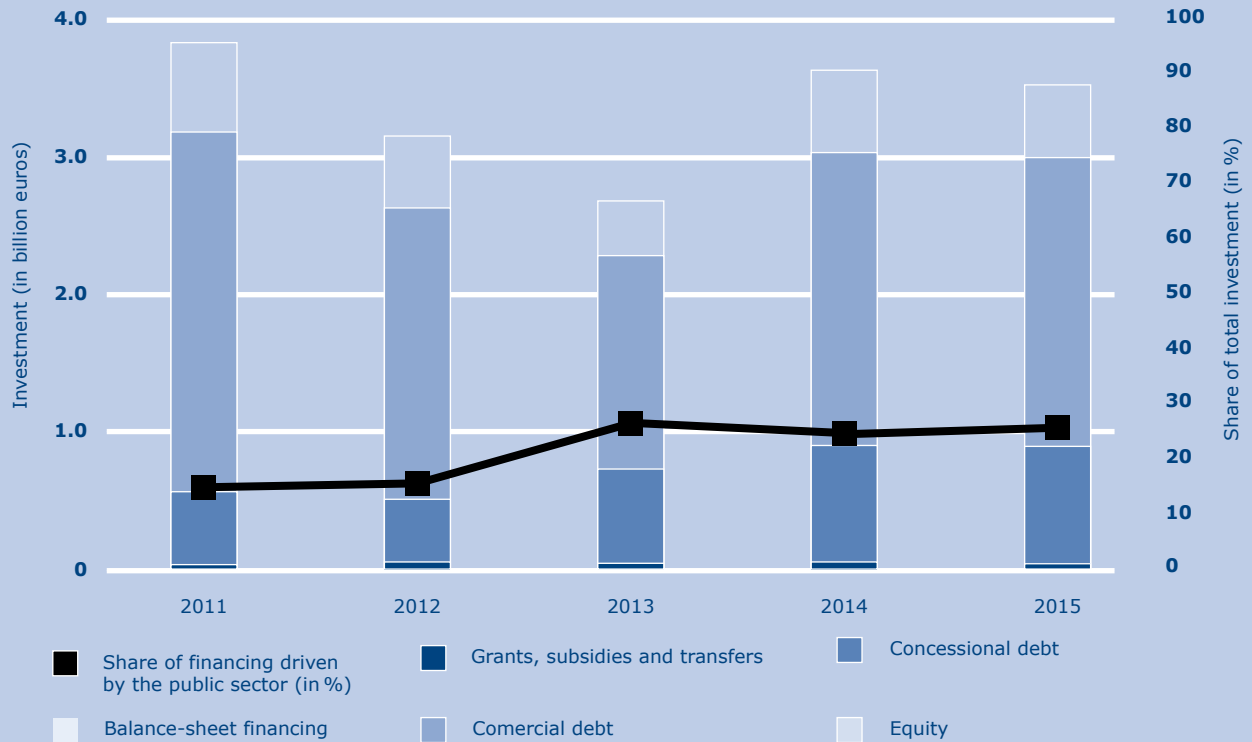
spontaneously, then it is of course to be positively noted that an excess of private finances are available today. Each publicly invested euro provides maximum leverage for private financing. A challenge exists for the public sector to create the conditions for finance intermediation to redirect private investments by guaranteeing an adequate return.

The financial sector, so far rather indifferent to climate issues, has approached the topic step by step with an increasing attention span starting from risk perspectives. Of the three risks, which Mark Carney differentiates (physical risk, transition risk, legal risk), the risk of the transition from the carbon world to a carbon-free world and the consequent world of stranded assets, is probably the main flash point of interest for the finance community about climate change.

The transition risk is especially critical for the enterprises which produce fossil fuel sources because in case of the two degree Celsius scenario, 80 percent of the coal, crude oil and natural gas reserves have to remain under the earth. Their share market value, however, is partly determined by the size of the confirmed reserves. On account of the influence of coal and crude oil companies on financial parameters, the argument of a “carbon bubble” gains credibility with long-term investors and regulatory bodies.

Banks, insurance companies and investors have assumed considerable obligations in 2015 and 2016 within the scope of the Montreal Carbon Pledge, to reduce their CO₂ footprint by disinvestment in the coal sector. Recently, 500 enterprises which in total manage over three trillion US dollars, have taken a similar decision. Climate financing has thereby found a permanent place on the agenda of international economic and financing governance.

INVESTMENTS IN RENEWABLE ENERGIES IN FRANCE



Source: Institute for Climate Economics

TRANSPARENCY AND REGULATION OF THE FINANCE SYSTEM

In France, investors must consider and be accountable for environmental aspects in their investment policy according to Article 173 of the statute on energy transition for green growth and especially the issues connected with climate risks. Although the relevant risk assessment methods have not yet been stipulated, the protagonists of the private sector have shown themselves to be extremely innovative considering the publication of this new type of strategic data. At end of October 2016, the Department of the Environment offered a prize "for the best reporting". This French standard should serve as guideline for international rules and standards.

Apart from the risk transparency, the handling of institutional investors with finances, the usage of benchmark indices as well as the institutional and regulatory environment of the financial system have to be aligned with the time horizon of the climate challenge. However, in its present form, this financial regulation depicts rather a brake for investments on account of the regulatory rules provided. Therefore, some protagonists are pleading for environmental risk to be included in the upcoming discussions about the future regulatory standards.

GREEN BONDS

The green financing business of banks remains marginal; green bonds provide one percent of the total bond market. Analogous to it, only one percent of the assets of institutional investors are invested in green and sustainable infrastructures. What makes the situation more difficult is the definition problem of the selection criteria for projects to have entitlement to green bond financing: nuclear energy projects, natural gas installations, coal power plants' rehabilitation? The definition of the criteria was till now left to the private sector on whose initiative the "green bonds principles" (2016) are based. The strong impulse

triggered by the issue of the first green state bonds by France in January 2017 (amounting to seven billion euros) will make a contribution to structuring this market.

In order to accelerate the growth of the green finance sector, the Stern-Stiglitz Review (2017) that defines a corridor of benchmarks for climate measures, recommends integrating such benchmarks into the financing instruments. If the value of the CO₂ emissions that were avoided with the help of green-financed investments is offset and guaranteed by the state sector, the risk of these investments is reduced and through it the financing costs will be more favourable.

CO₂ PRICING

The determination of a significant CO₂ price could accelerate the redirection of private finance towards low CO₂ investments. France pleaded in 2016 in the EU for a vigorous reform of the emission business. With the help of a price corridor, the market price signal should be adequately strengthened in order to trigger low CO₂ investments in the industry.

At the national level, in the energy transition law of 2015, France has established an ambitious development of CO₂ tax which shall increase from 30.5 euros per ton in 2017 to 56 euros per ton in 2020 and to 100 euros per ton in 2030. The CO₂ tax mainly concerns diffuse CO₂ emissions in the private transport and residential sector. This long-term development must now be set on a credible basis so that households and business enterprises can invest with corresponding confidence in the stability of the price development.

GIVE LONG-TERM INVESTMENTS A SOCIAL VALUE

Transparency in environmental risks, reporting of the two degree Celsius portfolios, new approaches to finance regulation, clear definition of green investments, CO₂ pricing and finance-engineering are necessary elements in order to align the financial system in a novel manner. All these elements are necessary to divert long-term investments in the battle against climate change. They are therefore of social benefit. This means that private finances need to be steered in harmony with big public investment projects more or less directly towards carbon-free projects. Without the involvement of the public when defining the course of action and the values to be achieved, any further investments from or on behalf of the central banks, or new investment incentives, will not have any long-term impact on growth.

Baptiste Perrissin Fabert is a specialist in climate finance at *France Stratégie*.