

Fostering investment in the green transition

Introduction: Delivering on the net zero transition requires substantial investment

The Chair observed that there is no dispute over the need for massive new investments in the order of €350 billion per year in this decade to meet EU targets for the transition to a net zero economy. This requires a multi pronged approach, including cutting emissions and a Schumpeterian creative destruction process producing investment. Projects such as the NextGenerationEU package are in place, but changing Europe's capital stock, production processes, consumer habits and technologies requires more investment and coordination between public and private sectors.

1. The uncertainties and drawbacks that need to be resolved or lifted are clearly identified

The Chair questioned what is inhibiting this investment if the need is clear. It could be any number of reasons: incorrect relative price incentives; a lack of financing; insufficient incentives from public authorities; a lack of international coordination with other initiatives; an absence of clearly defined regulatory frameworks enabling investors to be sure that their investments will have a good risk return profile; or a lack of skills among those implementing new investments.

1.1 The absorptive capacity, supply constraints, lack of skills in implementing projects and a failure to use the size of the Single Market are concrete obstacles

An IFI representative commented that 70% of municipalities believed they do not have access to climate related skills, either in the municipality or via consultants. That raises problems around designing interventions and implementation, which are the most binding public sector constraints. For the private sector, tightening financial conditions and uncertainty are key impediments for investment. In the last year, energy efficient investment survived the uncertainty effect, but uncertainty is weighing negatively on the whole package of climate mitigations and adaptations. The EU made a major step in reconfirming its climate ambition at the time of the energy crisis. The fragmentation of the EU market also works against investment and prevents European companies maximising the potential of the Single Market. Bureaucracy is also a constraint, with permits and authorisation often slowing down investment. While the Commission's proposals on permitting are excellent, implementation should be quick.

An official agreed that absorption capacity is very important for public investment. There is a great deal of EU level instruments dedicated to advance the green and digital transitions, including structural funds the EU budget, NextGenerationEU and REPowerEU. However, absorbing these funds institutionally seems to be quite challenging, especially for small countries' administrations. It was noted that the quality of public spending is key. The ultimate objective is not to spend the money but to achieve the transition which is not an easy task, especially in a market that is marked by supply constraints and strong demand.

The real binding constraint is access to skills

An IFI representative commented that 70% of municipalities believed they do not have access to climate related skills, either in the municipality or via consultants. That raises problems around designing interventions and implementation, which are the most binding public sector constraints. For the private sector, tightening financial conditions and uncertainty are key. In the last year, energy efficient investment survived the uncertainty effect, but uncertainty is weighing negatively on the whole package of climate mitigations and adaptations. The fragmentation of the EU market also works against investment and prevents European policymakers maximising the potential of the Single Market, in contrast to the US Inflation Reduction Act. Limiting this fragmentation is important. While the Commission's proposals on permitting are excellent, implementation cannot proceed if local authorities are not aware of them.

1.2 The lack of robust and transparent ESG data and investable projects

An industry representative stated that her organisation provides market data to a global customer base and takes its contributions to the green transition seriously. The fundamental problem is that the world needs significant capital investment in the order of \$100 trillion to achieve net zero by 2050. A fundamental blocker to this is the lack of robust, transparent ESG data. Having robust data is essential to the investment process because it creates transparency in decision making and enables investors to make sensible decisions around risk and return.

There is also a lack of investable projects. Energy infrastructure is a key factor in emissions reduction targets but there are few investment grade projects available to help achieve this, and this is exacerbated by the lack of data. Having access to widely disclosed and standardised data is an essential part of the investment process. 42% of publicly listed companies globally do not disclose scope 1 and 2 emissions, which are part of a core dataset. Only 16% of globally listed companies disclose transition plans. Policymakers have a real opportunity here to support the growth of the green economy by

mandating corporate disclosures and focusing on transition plans.

A policy maker commented that while Europe is ahead in disclosures, the landscape is complicated and a sophisticated, holistic approach is needed to deal with different situations. Few issuers will be taxonomy compliant at the outset, but it is not clear that they should not be eligible for sustainable finance investment and transition companies need to be supported. The approach taken must correspond to this complex reality. Asset managers are the ones using these disclosures and they must make the difference here. Joining these elements up is crucial, and Europe is moving in the right direction and creating solutions.

An official observed that while significant progress has been made to establish EU-wide regulatory framework in the field of green finance, the accessibility and availability of reliable data remain a major problem. Closing the data gap will be key to minimising greenwashing and mobilising private funds.

1.3 The absence of a credible transition path to stabilise expectations

1.3.1 A map of the investable projects that are central to delivery of this agenda and the capacity to implement

A policy maker stated that there is ample public and private capital to shift investment in a greener direction. Finance is a critical enabler, but it needs to be part of a cross government, economy wide strategy. This cannot be broken down into a single problem. Providing a map of investable projects is a core part of the strategy to deliver this agenda. The difficulties are easy to see in the timeframes involved in building a wind park. These realities need to be built into expectations around the transition.

1.3.2 The lack of a clear and fixed transition scenario

An official observed that coordination is a structural reason for the problem of absorption. During the pandemic, governments turned for solutions to doctors, resulting in overly expensive measures because costs did not figure highly in their thinking. Similarly, environmental experts have settled on an adaptation path without considering potential bottlenecks because of an overriding environmental objective. The adaptation path may not be optimal if all the costs and benefits are not assessed. While environmental experts have not made this calculation, investors will, because whether a project pays off is crucial to them. Investments in fossil fuel technologies will only represent stranded costs if sustainable technologies can produce enough energy to satisfy demand, and investors would not be wise to rely on this assumption.

The Chair asked if there should be a continuous supply of brown energy to avoid disruptions. The official replied that, even if it is unpleasant to keep using brown technologies longer than anticipated, it would be less pleasant for the lights to go out.

1.4 An effective carbon pricing system to create the right market based incentives for changing behaviour

The issue is not the availability of finance. A policy maker stated that effective carbon pricing is needed to create

market based incentives for changing behaviour. Europe is moving in the right direction with an emissions trading system (ETS) covering 40% of industrial emissions. If carbon pricing is to be changed, there must be support for the sectors and households affected by the adjustment. The Social Climate Fund makes €65 billion available for this agenda, partly funded by the ETS Innovation Fund.

An official observed much carbon taxation policy is implemented at Member State level and more could be done to promote harmonisation at the European level.

1.5 The lack of a business case logic in sustainability planning

A public representative stated that private money is more important than public money. The goal is to deliver the transition, not spend money. The Russian invasion of Ukraine and high energy prices triggered many investments in the transition and this momentum must be maintained.

Europe has a clear direction, with a climate law in place committing to reduce emissions by 55% in 2030 and heading to climate neutrality. There is also a strategy breaking down this goal into different categories. Money in the form of the NextGenerationEU project, the Modernisation Fund, the Social Fund and the EIB is also in place. Such a systematic approach has not been taken in many other countries. What Europe is missing is a consideration of business logic. It is necessary to consider why the financial industry funds some investments and not others. While the US's Inflation Reduction Act creates a single market by using federal policies, there are 27 different policies across the EU. Excessive bureaucracy and fragmented sustainability policies could impede the success of the transformation.

Offering consumers and businesses incentives to buy green is effective. If Europeans are offered €5,000 to buy an electric car rather than a petrol car, it will stimulate the production of electric cars very strongly and a lot of people will opt for electric cars. If businesses are offered a certain tax incentive to produce one kilogram of hydrogen, there will be a focus on generating green hydrogen. But the fragmented national approaches with complicated policies overlooks the business case logic, meaning more money is used to deliver less. This business case consideration needs to be added to provide an understanding of where the strategy does not work and how to promote it. The lack of investment occurs when public authorities fail to recognize that certain desired investments are too risky.

2. Solutions are well known but their implementation remains challenging

2.1 Addressing the challenging macro economic environment for fostering investment in the green transition

An industry representative observed that there is no single cause and therefore no single remedy. It is both a

macroeconomic problem and a microeconomic problem. The green transition was presented as a way to find a new growth strategy and welfare environment for Europe before the Covid crisis. This has become more challenging.

The European macroeconomic response to Covid has translated into the NextGenerationEU project, which seeks to provide public investment, structural reforms to improve markets and private investment to return to growth and deliver the green transition. Public money alone will not do the job, so it is necessary to convince private money to invest. There needs to be a suitable macroeconomic environment, which is now very different to that before Covid because Europe is in a multiplicity of crises. This uncertainty makes it impossible to be sure that the macroeconomic environment will remain constant long enough for investments to be activated. International Monetary Fund highlights new shocks hitting the global economy, such as secular stagnation, geopolitical concerns and fragmentation, all of which affect private investment.

It is also necessary to understand the microeconomic incentives, as uncertainty makes it difficult to prioritise between projects. Skills shortages affect both green and non green activities, so investment and education has to be pursued over a period of time, despite the risks.

2.2 Regulators should intervene to close the data gap

An industry representative commented that it is realistic to view private capital as the key to the transition, but access to high quality principles based data is necessary for this. This data must be independent and transparent. This independence and innovative data collection methodologies must be protected.

An industry representative agreed that the lack of data made it difficult to assess risk and decide where to invest, and building up data will take time. The BIS produces much useful data for investment, and this should support the transition. It is however necessary to understand the extent to which microeconomic data can transform itself into predictive behaviour and can enable the creation of the necessary financial instruments for the transition.

A policy maker observed that there is no shortage of data, and disclosures are in place. Structuring that data, ensuring responsible actors use that data and having a responsible intermediation ecosystem is required to put the data to good use. The social, economic and technological rewiring of a continent was never going to be fast or easy. The strategy is on the right track, but patience is needed.

An official stated that national level initiatives must fill regulatory gaps at European level, especially regarding data. Lithuania has prepared the national green finance action plan. The key pillar of the Plan is to establish a centralized and publicly available sustainability database with granular data on firms, including SMEs, and households all in one place to facilitate connection with investors. The Green Finance Institute will be set up to drive the green finance agenda and help the exchange ideas and best practices between the public and private sector.

2.3 We need to fully exploit the potential of the EU single market and NextGenerationEU to reap the competitive benefits of market scale

An IFI representative explained that the EIB is active in supporting the green transition and provides technical assistance as well as financing. The EIB supports the scaling up of firms and technologies and it is necessary for any solutions to overcome the fragmentation of support and take advantage of the size of the Single Market.

2.3.1 Removing barriers to investment that are preventing capital from reaching significant projects

An industry representative commented that sustainability should be viewed as a growth opportunity. The green economy is the fourth biggest industry sector, accounting for 7% of market capitalisation. That growth opportunity is going to attract private capital to the market, but this requires a supportive global regulatory framework to reduce complexity while retaining flexibility to support innovation across different sectors.

2.3.2 The Recovery and Resilience Fund should be fully exploited

A policy maker observed that €187 billion of expenditure under the Recovery and Resilience plans is destined for climate transition policies. REPowerEU will increase these amounts with a strong focus on energy diversification and support for renewable energy. If the right projects are identified, it will be possible to deliver a decisive impetus and definitively change the carbon-profile of public funded investment. ETS has already changed incentives and behaviours and the EU will accompany this with socioeconomic support (the new ETS financed Climate Social Fund with an envisaged budget of EUR 65bn for 28-34). There are also budgetary guarantees to de-risk investments and mobilise private capital.

2.3.3 Favouring a European approach rather than fragmented, national ones

A public representative stated that the European budget should finance a European approach, rather than subsidise Member States' budgets. Private money will do the trick and public policies should focus on creating the case for private investments.

2.3.4 Being more methodical

An industry representative emphasised taking a methodical approach. More substance must be given to the notion of circular economy. Multidisciplinary cooperation is needed to mobilise viable resources.

2.3.5 The energy price level in Europe must be competitive at the global level

An official commented that, where shortages cannot be avoided, the adaptation plan should be amended to become more realistic. The energy price level in Europe must be competitive with the US, requiring the cooperation of other partners is needed. Being a pioneer can be positive, but it can also result in taking the wrong decisions.

2.4 We need more incentives and financial players both able and willing to invest long term

An industry representative noted that the mobilisation of finance for the green transition remains lower than private and public finance flows into fossil fuels. The obstacles to green investment are tied to the need for this investment to be long term and risk tolerant. Infrastructure projects are a vital component of the green transition, but high upfront costs and regulatory and technological uncertainty hinder private capital mobilisation. Also, investments need to cover projects of all sizes and complexities. Quantifying results is also complex, so a taxonomy is needed to provide a common language for effective financing of the green transition.

The Chair asked if there are appropriate vehicles for green investment. The industry representative replied that there are standout vehicles such as blending instruments and promotional banks can help with project engineering. These promotional banks are crucial for the transition because their long term management horizon lets them finance projects that would not be otherwise viable. Public financing through the InvestEU mechanism is important for developing financial instruments with promotional banks.