Extract from the synthesis of the Green Forum 2012, organised by WWF, on "A green path of growth for the European economy?"

How can a green economic recovery in Europe be financed?

A vital factor in implementing a green recovery of the economy will be the long-term investment in the lead sectors of the future. What financial tools do we have in order to support green investment? What role can public/private partnerships play?

Dimitri Zenghelis, Visiting Senior Fellow at the Grantham Research Institute – London School of Economics (LSE), Associate Fellow of the Energy, Environment and Development Programme at Chatham House, Senior Economic Advisor to Cisco. Between 2007 and 2008, he was Head of the Stern Review Team

Ivan Fauchaux, Energy and Circular Economy Program Director, French PM Office for Investment

Nathalie Girouard, Coordinator Green Growth and Sustainable Development, Organisation for Economic Co-operation and Development (OECD)

Stuart Clenaghan, Principal of Eco System Services Limited and Advisor to the Climate Bonds Initiative

Head of the round table: **Stéphane Voisin**, Head of Sustainability Research & Responsible Investment, CA Cheuvreux

Private investment: invaluable support for ecological recovery

The transition to a greener economy will require major shifts in long-term investment towards low-carbon and climate-resilient infrastructure, in the energy, transport, water and buildings sectors. There is already an infrastructure investment gap, and the key is to ensure it is filled with green rather than brown infrastructure.

In the face of increasing strains on public funds, private investments will be needed to meet part of the growing infrastructure needs. As the motor of development, private investment and finance will be key to long-term financial sustainability of the green infrastructure challenge.

Nathalie Girouard opened the debate by presenting the OECD report ***Towards a Green Investment Policy Framework***. The OECD got a mandate from national governments in 2009 to put this report together outlining how both financial and climate crises can be solved simultaneously. The report has found that as the public funds are drying up, it is essential to attract private investment to combat climate issues. Yet there are significant barriers to private sector engagement in climate action. Some of these barriers are linked to the nature of infrastructure needed, which usually requires high upfront capital, low return and very long investment timeline.

Other barriers emerge due to the failure of the climate markets as investors lack familiarity with “low carbon, climate resilient” (LCR) investment opportunities, the policy risk attached to these investments is rather high and they are less profitable than other investments available on the markets.

The context is also unfavorable to LCR investments as new financial regulation (Basel III) limits capital availability and the project finance is drying up. In short, the risk and return balance at the moment does not provide enough incentives for increased private investments in the LRC infrastructures.

Yet, public policies could step in and correct this balance by leveraging some public finance and using smart regulation. This could be achieved by following five steps:

1. Establishing **clear goals and rules of the game**;
2. Enabling **green investment** by crushing monopolies and opening up the markets;
3. Mobilizing **green finance using innovative financial tools** to reduce green investment risk and facilitate market liquidity such as government-sponsored green bonds, or instruments such as loan guarantees to leverage limited public funds with private investment;
4. Harnessing resources and **building capacity for a LCR economy**;
5. **Promoting green businesses** and consumer behaviour.

Public sector involvement: vital to build private sector confidence

Public authorities must create conditions that foster confidence in order for private financial players to invest in the ecological transition.
Dimitri Zenghelis

Dimitri Zenghelis gave a macroeconomic picture of the current financial crisis and explained how it relates to climate issues. Climate issues cannot be tackled before the economic crisis is resolved.

According to Mr. Zenghelis, sustainable economic growth requires:

1. **Resolution of the current debt crisis in Europe by mutualisation of national debts**. EU as a whole has a relatively low sovereign debt, therefore, the main challenge is to bring back growth on the continent.
2. **Shared fiscal responsibilities including a long term mechanism for cross border fiscal flows**, which would prevent the buildup of future imbalances.
3. **A program to encourage private sector investment and stimulate growth**, at the center of which should be a policy-driven European transformation to a resource-efficient economy.

The financial crisis is holding back green investment because at the moment investors do not want to take any risks and prefer dumping money on national risk free bonds with negative yields. As the private sector increases its saving, the public sector has to pick up the bill. However, private savings with low returns are widely available, a situation which could be used in favour of green investment projects.

According to Dimitri Zenghelis, public sector dissaving would generate positive signals to the private sector which would be reassured by the opportunities of long-term investment. The combat to improve energy and resource efficiency could contribute to providing a solution. This will consequently incur costs (electric grids, reindustrialisation and creation of employment) notably at the initial stage, which must be assumed, but will also present opportunities to stimulate economic recovery.

A programme to encourage private sector investment in green growth can only be established after the financial crisis is resolved. If this happens though, **Europe is best placed to lead the green growth revolution**. Standards, regulations and a stable carbon price would facilitate the private sector's involvement into green growth.

To illustrate the positive impact that a credible public policy can have on generating private investment, Dimitri Zenghelis gave the example of the Kyoto Protocol adopted in 1997. Private investments in new low-carbon technologies (solar energy, photovoltaic systems, hybrid cars etc.) increased significantly due to greater overall policy coordination. There is no shortage of private capital or investment opportunities. **In transitioning to a green economy, the recovery of private sector confidence is a key factor which can only be instilled by public sector involvement**.

Most green investments require a long-term commitment, sometimes for up to 40 years. Public sector involvement, notably in terms of the choice of investments, is therefore vital for a society with a forward-looking approach. **Ivan Faucheux**

Ivan Faucheux presented the Strategic Investment Programme of France (Grand Emprunt). The programme consists of 35bn euros to be deployed until 2020. Investments are to be processed by state operators with strong focus on governance and accountability and including private co-investors. Priorities of the Programme are echoing the Europe 2020 strategy and put emphasis on innovation economy and sustainable development.

Funds were rapidly allocated to higher education and research projects, but it has been difficult to identify projects which meet the criteria relating to profitability and the environment within the areas of energy and the circular economy. Paradoxically, part of the Grand Emprunt has not yet been allocated, there are not enough projects and consequently not enough co-investors willing to go into these sectors.

Public intervention of this type is needed because the private sector is often looking for short term investment with a maximum duration of 8 years, whereas many of the green projects might take up to 40 years to be completed. The "short termism" is especially true in the current times of economic mayhem. However, public resources are rare and new technologies are risky. In a forward looking society, public sector involvement is vital, notably in its choice of investments. This could be in a direct way, or by transforming short-term investments into long-term investments.

To conclude, **Ivan Faucheaux** raised the subject of trans-generational exchange mechanisms which could hold back private investment in green sectors. The development of innovative financial instruments will be part of the solution.

The bond market: powerful leverage effect for green investments

The bond market represents significant potential for investment in green projects and would provide increased investment on a large scale.
Stuart Clenaghan

In order to finance large infrastructure projects, notably in the transport, energy and information networks, the European Commission have introduced project bonds that are managed by the European Investment Bank (EIB). To finance and invest in the green recovery of the European economy with the support of private investors, the speakers referred to another solution which would be to restructure the bond market. Furthermore, the World Bank has been issuing Green bonds since 2008 to supplement its activity in green projects.

Stuart Clenaghan presented the activity of **Climate Bonds Initiative**, an NGO with large membership and a panel of advisors. The Climate Bonds Initiative convenes issuers, investors and banks, provides policy models and governance advice, sets climate bond standards and carries out research activities.

Bonds are a very important mechanism of financing as bond markets make up twice the size of equity markets ($100trln versus $55trln). Half of the bonds are issued by governments, 40 percent by financial institutions and $80trln worth of bonds are managed by institutional clients. According to the research of the Climate Bonds Initiative, only $174bn worth of bonds are related to energy, building and industry, transport, climate finance, water, waste and pollution control, agriculture and forestry. 70% of this amount goes into transport (rail) financing. Therefore, **the potential for bond investment into green projects is enormous**.

Policy support is needed to attract private capital. Clear standards of green projects should be developed, regulatory mechanisms established and tax policies adapted.

The CBI is working in this direction in order to establish clear environmental criteria in setting bond standards. These standards also enable investors to identify and differentiate between green and conventional bonds, and to assess investment opportunities. The implementation of appropriate taxation policies as well as regulatory mechanisms will also allow conventional bonds to be converted and therefore finance the transition towards a green economy.

Ivan Faucheux explained that project bonds are currently in a trial phase in France, and for the moment the projects identified are in the digital sector. However, no investment projects in the area of sustainability have been identified that could be used in conjunction with the “Grand Emprunt”. In his opinion, these project bonds are interesting as they would mutualise risk. In the context of heavily indebted member States and when public guarantees are still an illusion, it remains to establish who is the guarantor, who is responsible for failure and to what limit.

In concluding the round table, **Stéphane Voisin** reminded us that in 2004 the financial markets were attracted by environmental projects and went on to invest heavily in ‘Renewables’: solar energy, wind power and biofuels. Before 2008, the promises of renewable energies were as spectacular as the fall in share prices during the economic crisis and the drastic cuts in government subsidies for the green economy. However, the investors who had directly acquired green assets such as solar panels, wind farms and biomass plants, but not the companies linked to these assets, made a profit. This is tangible proof of the tendency for financial markets to create speculative bubbles that are disconnected from the economic and industrial reality. The problem is that investors will remember this: there has since been a lack of confidence in the short and medium term for organisations involved in green technologies. In this context, the implementation of new financial instruments and an innovative financial framework, that are geared towards assets (notably via bond markets and project bonds) and not towards shares in companies in the stock market, could provide a hopeful solution.

Discussion with the audience

Following the round table, discussions focused on the **need to establish a framework for a clear, long-term policy that would provide financing for the transition to a green economy**. This framework should foster better coordination between the public sector who lack resources and the private sector who lack visibility. It should also provide a means of effectively dealing with the lack of confidence linked to green investments.

Nicolas Pirotte, Deputy Chief of staff to Jean-Marc Nollet, Ministry of sustainable development, Walloon government, wished to point out that by leaving the macroeconomic framework, the majority of economic players likely to take part in economic recovery would be the SMEs. Financial levers guarantee mechanisms for stimulating green investments also exist at this level, for example Oséo. Bringing together these players and restoring confidence is required for environmental transition, and can be easier to implement as the risks and amounts invested are reduced.

Nathalie Girouard rounded up on the subject of confidence and risk profile linked to green investment, by saying that the implementation of a framework for a clear, long-term transitional policy towards a green economy requires political courage and leadership at public sector level, as well as innovative governance with notably stronger inter-ministerial cooperation.

To conclude, she gave examples of South Korea and Norway. The former put green growth as top priority in its development plan and set up a ‘Green growth committee’ which is higher than ministry level and under the responsibility of the President, and which has delivered significant results. The latter integrated sustainable development into the finance minister’s portfolio, and can also integrate medium-term investment and development policies into the economic policy. These new forms of governance should be used alongside innovative financial instruments which would allow improved coordination of public policies and more effective public action in the long-term on the path to transition towards a green economy.

Kristina Maslauskaite, Research fellow, Notre Europe