PRESIDENCY ISSUES NOTE

WORKING SESSION I:

SUSTAINABLE FINANCING OF GREEN TRANSITION

INTRODUCTION

The substantial investment needs required to achieve net zero targets, coupled with mounting structural challenges and significant fiscal constraints facing EU governments, make it imperative that the private sector also plays a major role in financing the climate transition. This issues note, based on the cross-country analysis and policy advice provided by the OECD[1], as well as the specific insight of the Hungarian Government Debt Management Agency, aims to highlight the possible elements of a successful policy framework to mobilise more resources for sustainable financing of the green transition in the EU.

THE FINANCING CHALLENGE

How to boost investment in green transition to achieve the EU's ambitious climate targets is a critical policy challenge the EU and its Member States have to face in the upcoming decades. The amount of investment required to reach net zero emissions by 2050 is estimated to be around 2 ¾ percent of the EU's GDP annually, while the ability of fiscal policy to support the green transition will remain constrained by long-term fiscal pressures and already elevated public debt levels. Geopolitical tensions, global value chain disruptions and increasing barriers to international trade could further exacerbate the financing challenge.

Given the limited fiscal space, reducing emissions in an economically and socially sustainable manner will require an improved policy framework to mobilise and reallocate substantial and sustained private investment flows. To this end, it is essential to strengthen the business case for investment in climate transition in the EU, for both institutional and retail investors.

[1] *Financing the climate transition in the European Union.* OECD Background document for the informal ECOFIN meeting 13-14 September 2024

PUBLIC INVESTMENT TO ADDRESS MARKET FAILURES

In order to catalyse (or complement) private investment in the climate transition, public financing remains essential for investment in infrastructure and innovation in particular. While stimulating economic growth in general, public investment in infrastructure and innovation can also drive the development and deployment of green technologies by the private sector.

Public resources should be focused in areas where private investment is unlikely to be realised without public intervention, either at national or EU level. Such areas of infrastructure notably include electricity grids and storage, cross-border energy interconnections, charging infrastructure for electric vehicles or energy efficiency of public buildings. Fostering basic research and creating a conducive business environment that effectively spurs green innovation in the private sector is also a domain where governments need to play an instrumental role.

POLICIES TO IMPROVE RISK-RETURN BALANCE OF CLIMATE INVESTMENT

Climate policies, including subsidies, emission pricing, regulation and standards, as well as a range of enabling complementary policies, are crucial to channel private investment in green projects by increasing, where appropriate, the risk-adjusted return on climate related investment. To achieve the right incentive effect, the climate policy framework needs to be coherent, transparent, credible, evidence-based and predictable, and should be based on sound long-term policy commitments, as climate policy uncertainty particularly hinders business investment.

Another course of action to reduce policy uncertainty is aligning infrastructure planning and regulatory frameworks with emission reduction targets, which can advance investment directed towards projects that contribute to climate goals.

Enhanced investor information can also contribute to directing private capital towards more sustainable investment by ensuring that investors can make informed decisions e.g. by having sufficient information to evaluate firms' exposure to climate change.

REFORMS TO MAKE THE EU AN ATTRACTIVE INVESTMENT DESTINATION

To attract more private investment, including for climate transition, structural reforms to improve the EU’s overall competitiveness should be scaled up as well.

EU level reform priorities include further deepening of the Single Market, completion of the Capital Markets Union and, not less importantly, progress towards a unified EU energy market (deepening cross-border connections, review of energy price formation etc.). The EU reform agenda should be complemented by stepping up productivity enhancing reforms such as reducing the administrative burden, easing business entry and exit, strengthening competition and improving access to finance, especially in equity markets and for SMEs.

A CASE FOR MOBILISING IDLE MONEY FOR THE GREEN TRANSITION

While in recent years there has been an increased accumulation of private savings in the EU, 60 per cent of households' financial assets remain invested in low-risk products, more than half of which is held in currency and bank deposits. There is a strong potential in mobilising "idle money" for the green transition not only by orienting more private savings (e.g. pension plans, insurance) towards financing long-term green investment, but also by developing attractive government retail debt programmes to tap private savings that private institutions would be unable to mobilise (e.g. cash) or at least not in a way that they can directly finance green investment (e.g. current account deposits).

Hungary's experience demonstrates that government bonds can significantly increase the retail participation in capital markets, thereby expanding the potential financing capacity for the green transition.

QUESTIONS FOR DISCUSSION

1. What is the role of macroeconomic policies in the green transition? How can the limited fiscal space be used most effectively to achieve net zero targets? Can monetary policy play a role beyond providing a stable, low-inflation environment?
2. What are the key structural constraints to green business investment in Europe? Which climate policies can improve the business case for investing in the climate transition? Are the available policy options politically feasible?
3. How can "idle money" be mobilised for financing investment in the green transition? What role can government retail debt programmes play?