Olli Rehn: Making the best out of second-best climate policies

Opening remarks by Mr Olli Rehn, Governor of the Bank of Finland, at the Bank of Finland and the Finnish Ministry of Finance conference "Greener Finance for Sustainable Future", Helsinki, 30 October 2019.

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Ladies and Gentlemen,

It is a great pleasure to welcome all of you to this conference, organised jointly by the Bank of Finland and the Ministry of Finance. As Minister Mika Lintilä just pointed out, promoting sustainable and green finance is one of the key priorities of the Finnish EU Presidency. Indeed, it has to be, as climate change is an existential threat to the future of our planet.

People sometimes think that climate change mitigation is difficult or a relatively new challenge. But I would argue that we have known most if not all the pieces of the puzzle for over 30 years, even though we have not yet been able to solve the puzzle. Now, let me explain why we should not wait for another 30 years before solving it.

In 1987, the World Commission on Environment and Development – the so-called Brundtland Commission – released a report entitled *Our Common Future*. I am a proud owner of the first edition of that report, which highlighted that economic growth, ecological sustainability and social justice cannot be separated from each other, if we want to achieve sustainable development.

In 2006, Lord Nicholas Stern, who is here with us today, released the landmark *Stern Review* that links climate change and economics. One of its central theses is that climate change is the largest market failure ever seen. Because CO2 emissions are an externality, market forces alone will not solve the problem without a global public policy.

While street demonstrations and citizen activism play an important role in pressing for more ambitious climate action, what we need in terms of public policy is consistent, systemic and rational policy solutions to achieve effective concrete results.

Systemic in the sense that they need to cover and bite in energy production, transport fuels and manufacturing industries widely. Rational in the sense that they need to lean on insights based on theory and evidence – “In science we trust”. Economics can provide such insights on which policies actually work.

Based on economics and policy analysis, there are three essential and widely accepted requirements for an effective climate policy.

The first is efficiency, which implies that we should design policy action so that we get the biggest emission reductions for a buck.

The second requirement is that climate policy needs to be fair. The cost of transition needs to be evenly shared, and in such a way that also takes into account historical responsibility for emissions.

Thirdly, the policy needs to address the free-rider problem by ensuring that everyone has an incentive to take part in the system. Since climate change is a truly global problem, it implies by definition that we need solutions that in the end have a global scope. Free-riding and carbon leakage would simply erode the work of even the best of students.

Based on these three requirements, the first-best solution to limiting CO2 emissions would be a global carbon tax. Many economists have expressed their support for such a solution.[1]

In order to be effective, a global carbon tax would need to be complemented with a border carbon adjustment to avoid countries undermining the system by not signing up to it.

When theories are put into practice, however, policymakers face the complexity of the real world. The sense of urgency on climate action seems to vary from country to country across the global arena. Second-best solutions are therefore necessary as medium-term transitional measures, whether we like it or not. We have prominent regional and national initiatives, based on international treaties, in place that aim at effective climate change mitigation.

Ladies and Gentlemen,

In that spirit, the European Commission adopted an ambitious *European climate and energy strategy* first in 2008 and a revised one in 2013. Still today, they form the basis on which the Member States build their national climate policies.

Later on, as the Minister of Economic Affairs in 2015 to 2016, I had the honour to present to the Finnish Parliament the *National Energy and Climate Strategy* to 2030.[2] Not only did this strategy implement the EU-level goals, in many cases it went far beyond them.

I will highlight only a few points from the strategy. The central target is that the share of renewable energy in end consumption would increase to 50%. The share of transport biofuels would rise to 30%, with the parallel aim of significantly increasing the usage of electric and gas-powered vehicles. By the end of 2029, coal would no longer be used for energy production in Finland.

Overall, this is the background for Finland as the EU Presidency aiming to move forward an ambitious global climate agenda.

The new President-elect of the European Commission, Ursula von der Leyen, has promised to propose a European Green Deal within the first 100 days in office. It would include an extension of the Emissions Trading Scheme, a Carbon Border Tax and a Cohesion Fund to support those regions that are most vulnerable to the transition. Furthermore, the new Commission wants to set more ambitious climate targets for the EU for 2030.

Sustainable finance is a critical area where the EU can support the transition. In addition to "traditional" EU funding that can be used to finance sustainable investments, the European Fund for Strategic Investments is an important source of such funding. The enhanced version of this Fund aims to mobilise over 500 billion euros by 2020, of which a significant part will be directed to sustainable investments.

One cannot talk about green finance in Europe without mentioning the European Investment Bank (EIB). EIB President Werner Hoyer has recently indicated that the EIB, together with public and private partners, aims to unlock at least 1 trillion euros in sustainable investments by 2030. But we will likely hear more about the role of the EIB soon from its Vice President, Alexander Stubb.

Ladies and Gentlemen,

Europe is currently the world's largest market for Green Bonds and loans linked to environmental, social and governance goals (ESG). These instruments will play a key role in helping the EU become climate-neutral by 2050 – or preferably much earlier.

One of the first steps to enhance sustainable finance in the EU will be the completion of the EU Sustainable Finance Taxonomy. The Taxonomy is aimed at building a common definition of sustainability, and we will hear more about its importance later today.

Building on the Taxonomy, the EU should finalise its EU Green Bond Standard, which is already on its way. By harmonising the requirements, we can standardise verification, lower the costs of issuing bonds, and minimise the risk of green-washing.

This should encourage more active participation, thus boosting the supply of projects that could be financed with Green Bonds. Similar treatment of other types of sustainable instruments should be considered. We will hear about the instruments in the last panel of today.

Ladies and Gentlemen,

While the responsibility for climate policy lies with governments, central banks and financial supervisors are working actively to support progress.

Climate change creates two types of financial stability risks: physical risks resulting from extreme weather conditions and transition risks caused by the exit from carbon-intensive business models.

With the help of the *Network for Greening the Financial System (NGFS)*, central banks and supervisors analyse climate risks and enhance the role of sustainable finance. The recent recommendations of the network provide a good basis for climate action by all central banks globally.

Lastly, in order to limit global warming to 1.5 degrees, we need urgent measures. As noted earlier, we have known most if not all the pieces of this puzzle for at least 30 years. In the next 30 years, we must solve the puzzle. Not solving it would be an Epic Fail, really failing future generations.

Ladies and Gentlemen, Dear Friends,

Let me now invite onto the stage Lord Nicholas Stern, who will give us his insights on the policies needed to achieve a sustainable future. Nicholas Stern is currently Professor of Economics and Government at the London School of Economics, and he has received several awards for his ground-breaking work on economics and climate change.

In 2015, Nicholas Stern published a book entitled *Why Are We Waiting?* It looked at the progress since the Stern Review and found it had been too slow. Financial crises had led to some wavering in the wealthier countries.

Despite this, the book provides a cautiously optimistic take. This is based on the idea that we still have many routes open. We have not painted ourselves into a corner and we can still choose the right way forward.

Without further ado, Lord Stern, the floor is yours. And once more, welcome everybody!

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[1] www.econstatement.org/

[2] *The document can be found here:* tem.fi/en/energy-and-climate-strategy-2016