Event wrap-ups

87th East Jour Fixe: CESEE's second transition – challenges on the road to low-carbon economies

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Having successfully transitioned to market economies over the past three decades, the countries of Central, Eastern and Southeastern Europe (CESEE) now face the challenges of a "second" transition toward carbon neutrality. The OeNB's most recent East Jour Fixe[2] on June 17, 2021, mapped this endeavor by comparing past, present and future climate policy strategies in CESEE and other EU member economies. In his opening remarks, OeNB Governor *Robert Holzmann* reminded participants of the challenges and opportunities arising from the fact that the region's fossil-based economies are still in the process of catching up. Explaining the motivation behind the event, he pointed to the exposure of Austrian banks to CESEE economies from the perspective of climate-related risks: since climate-related risks are also financial risks, the Oesterreichische Nationalbank (OeNB) must consider these risks in its supervisory tasks.

Climate change and policies: where do CESEE economies stand?

In the first session, *Andreas Breitenfellner* and *Thomas Reininger* (both lead economists at the OeNB's Foreign Research Division) took stock of the green transition in CESEE. In their view, the physical risks of climate change are broadly the same for the CESEE economies and other EU member states. Transition risks, in contrast, that occur on the bumpy road to a low-carbon economy are more of an issue in CESEE. After CESEE EU member states had achieved sizable cuts in greenhouse gas emissions – linked to the profound structural changes in their economies – in the first decade of their "first" transition, further emission reductions were substantially smaller and below those of other EU member states. Thus, on average, CESEE economies are to some degree lagging behind the rest of the EU. Both CESEE and other EU member states must step up their efforts in the coming years. This would also offer great economic opportunities in terms of energy efficiency, low-cost renewables, energy independence and modernized infrastructure.

In the following discussion, moderated by the OeNB's chief economist *Doris Ritzberger-Grünwald*, *Ada Ámon* (Chief Climate Advisor to the Mayor of Budapest) and *Piotr Arak* (Director of the Polish Economic Institute) shared their views on climate-related issues from both national and European perspectives. The two discussants reflected critically on the climate change awareness of people living in Hungary and Poland and their willingness to take action. They also covered the coal industry in Poland, the use of EU funds for climate-related projects in CESEE, and implications of EU climate policies for Western Balkan economies. Ámon argued that – at least in the capital Budapest – there certainly is awareness, but no willingness to take the actions needed. She also sensed that the ruling government may

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[2] *The presentations and the workshop program are available at: https://www.oenb.at/en/Calendar/2021/2021-06-17-east-jour-fixe.html*

not be interested in meaningfully addressing climate policy issues in Hungary. In her opinion, EU taxpayers should watch closely how EU funds are being used for climate-related projects and whether these projects are being realized in the end. Regarding the Western Balkans, she highlighted the large heterogeneity between countries with respect to their energy mix and their huge potential for renewable energy. Arak explained that people in Poland are aware of climate change, but do not want to pay more for energy. In this respect, he raised the issues of energy poverty and energy cost inflation (in part driven by rising emissions trading scheme (ETS) prices) in his country. Concerning Poland's energy mix, he drew attention to investments in wind parks and photovoltaic installations as well as to further investment plans to increase the share of these renewable energy sources. He pointed to the political importance of the country's coal regions, whose population accounts for a large number of votes. The loss of jobs in the coal industry, which dates back to the 1990s, is still subject to political debates in Poland. Finally, Arak argued that it is not realistic for Poland to become climate neutral by 2050.

Investment needs for CESEE's green transition

The keynote speech of the OeNB's 87th East Jour Fixe was delivered by *Harry Boyd-Carpenter* (Managing Director for Green Economy and Climate Action at the European Bank for Reconstruction and Development – EBRD), who spoke about the "Investment needs for CESEE's green transition." He pointed out that the goal of net zero emissions by 2050 requires an unprecedented energy transition which must aim at a far larger share of renewables, mainly at the cost of coal and oil, while ensuring that the total primary energy demand will not be higher in 2050 than in 2018. Thus, wind, solar and other renewables like geothermal and biofuels as well as increased energy efficiency must be among the main sources of emission reductions to realize necessary interim targets by 2030. Consequently, investment in CESEE up until then should focus on the following three key areas: (1) energy efficiency – by e.g. progressively renovating both public buildings and residential buildings; (2) renewable energy – by building power plants and promoting network investments through regulated utilities; (3) transport electrification – by increasing the share of electric vehicles in new sales despite higher up-front costs (compared to competitive lifetime costs) and expanding the electric vehicle charging infrastructure. Boyd-Carpenter agreed with the moderator, *Helene Schuberth* (Head of the OeNB's Foreign Research Division) that expanding the provision of public transport, such as railways and urban transport services, would be needed as well. To enable these investments, he highlighted the need for establishing a meaningful carbon price and setting minimum standards. At present, financing is not a constraint, given abundant liquidity, but a rise in long-term interest rates in the future would make investment projects more difficult. He also saw limited potential for expanding hydropower, given environmental challenges and the low cost of energy from other renewable sources like solar. *Jürgen Schneider* (Head of the Directorate General for Climate Action and Energy at the Austrian Federal Ministry for Climate Action, Environment, Energy, Mobility, Innovation and Technology) supported this view, emphasizing both the challenge of complying with the EU Water Framework Directive and the need for involving residents early on. More generally, Schneider reviewed the most recent changes to EU policies. EU climate law will soon enter into force, requiring climate neutrality by 2050 and emission reductions of 55% by 2030. Austria has set itself the goal of becoming climate neutral by 2040 and switching to fully renewables-based electricity production by 2030, supported by the introduction of a carbon pricing scheme in early 2022. He concluded by highlighting the need for fostering climate transition through policy-supported adjustments in the labor market.

Steering the financial sector to address the climate challenge

The final round of discussion, chaired by *Andreas Breitenfellner*, addressed the role of banks and supervisors in the low-carbon transition. *Katrin Ganswindt* (Team Coordinator for Coal and Divestment Campaigns at urgewald e.V.) criticized the term "net zero" for being misleading and the transition timeline until 2050 for being too long – intermediate targets are needed on the way. She acknowledged the efforts of 31 banks (including Raiffeisen Bank International – RBI) to implement policies aimed at divesting from companies that extract and use coal, since big polluters would need financial restrictions. She recommended, however, to use additional metrics for exclusion thresholds, given that the complex business structure of those companies makes it difficult to determine the total share of coal in revenues. *Gábor Gyura* (Head of the Sustainable Finance Department at the Magyar Nemzeti Bank – MNB) emphasized that the MNB had introduced a comprehensive sustainable finance strategy. By pursuing a clear legal green mandate to support environmental policy in Hungary, without endangering its primary mandate of price stability, the MNB even went beyond the consensus among central banks which focuses on addressing climate risks as part of their mandate. Thus, the MNB is encouraging green lending and introduced preferential capital requirements for renewable energy lending, green bond investments and energy-efficient mortgages. RBI, for their part, signed the UN-led Principles for Responsible Banking and published a new coal policy in early 2021, as was pointed out by *Roland Mechtler* (Head of Group Regulatory Affairs & Data Governance at RBI). Taking these issues seriously implies a lot of in-depth work to obtain the necessary data from customers (i.e. firms). Their reporting has yet to be established, however, and this will take time. What is more, companies need to carefully choose the timing of investments: if they invest too early, they may lose money; if they invest too late, they may receive no financing. Hence, a benchmark guiding companies in their decisions is needed. Mechtler also recalled that the S in ESG, i.e. the social dimension of environmental, social and governance criteria, is often overlooked, but nonetheless very important in political decision making. Ganswindt, though, defended the E in ESG being disproportionately significant, as climate change worsens social problems and decarbonization helps solve them. *Josef Meichenitsch* (Head of the OeNB's Supervision Policy, Regulation and Strategy Division) compared ESG-related policies with anti-money laundering legislation which had turned from a soft to a hard topic in the last decade, with the ECB even withdrawing several bank licenses on money-laundering grounds. Every regulatory topic has its own life cycle, and ESG is somewhere in the middle, with regulatory measures getting tougher. The OeNB's supervisory arm has started to conduct climate stress tests making risks visible and measurable, the results of which will be published in late 2021. Applying a top-down approach, they investigate emission intensity at the industry and economy level using publicly available data and scenarios as well as the OeNB's own model to estimate potential losses of companies, and their impact on banks. CESEE countries are only included by assumption, although the OeNB has started to engage in a dialogue with some central banks in the region. Mechtler added that RBI is trying to align all CESEE subsidiaries which, apart from the group's policies, must also reflect the transition paths of their countries. Gyura emphasized that subsidiaries of Austrian banks in Hungary get impulses from many sides (including from the ECB, the European Banking Authority (EBA) as well as Austrian and Hungarian supervisors), which calls for further coordination, as the MNB, for instance, is also working on a climate stress test. He concluded by inviting OeNB supervisors to a green finance workshop focusing on CESEE, which will be held by the MNB around early December 2021 in Budapest.