

Chapter 7

Financing Energy and Low-Carbon Investment in Europe: Public Guarantees and the ECB

Etienne Espagne
CEPII, France

Michel Aglietta
CEPII, France

ABSTRACT

The Eurozone has been said to have caught a disease called “secular stagnation”. The engineering of a powerful investment drive seems the only way out of this self-fulfilling low-growth trap. The European Union has already set investment objectives in the Climate and Energy Package, related to four key sectors. Several financing tools need to be combined to tailor risk-sharing devices for investments in each sector. This can be achieved through a two-tier approach. First, for the four key sectors, a high notional carbon price is used to set an asset value on the carbon saved by new investments (“carbon asset”): these assets are accepted as repayment by central banks, and publically guaranteed. The ECB, by buying financial instruments issued by the low-carbon investors, creates a direct transmission channel to these areas of the economy. Second, fiscal measures ensure the carbon price catches up with the notional value, thus generating revenues that allow for the purchase of the carbon debt held by the central banks, guaranteeing the final budget neutrality of the process.

INTRODUCTION

The eurozone has been said to have caught a disease called “secular stagnation”. Productive investment in the private sector fell by about 20% overall between 2007 and 2014, while private saving has surged, creating a huge gap between gross domestic savings and investment. The trajectory of actual GDP has decoupled from successive estimates of potential GDP, and there is no sign of a spontaneous short-term adjustment. The engineering of a powerful investment drive seems the only way out of this self-fulfilling low-growth trap.

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The European Union has already set investment objectives in the Climate and Energy Package. These targets cover four areas: renewable energy supply capacity, electricity distribution networks, energy efficiency in building renovation and urban mobility. Several financing tools need to be combined to tailor risk-sharing devices for investments in each of these sectors. First and foremost, is the integration of a high carbon price. However, as any sudden sharp increase in the overall carbon price would have a major (and politically unsustainable) impact on the rest of the economy, a core issue is how to create a transitory distinction between the carbon price included/paid by the existing capital stock and the carbon price included/paid by new low carbon investments.

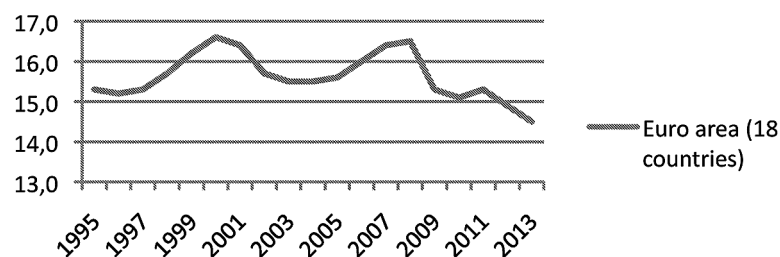
This can be achieved through a two-tier approach. First, for the four key sectors, a high notional carbon price is used to set an asset value on the carbon saved by new investments (“carbon asset”): these assets are accepted as repayment by central banks, and publically guaranteed. The ECB, by buying financial instruments issued by the low-carbon investors, creates a direct transmission channel to these areas of the economy. Second, fiscal measures ensure the carbon price catches up with the notional value, thus generating revenues that allow for the purchase of the carbon debt held by the central banks, guaranteeing the final budget neutrality of the process. By focusing on investments in these four sectors, the European output gap could be closed in the short run and a credible path opened to a low carbon economy.

THE CURSE OF LOW GROWTH IN THE EUROZONE

For the last seven years (2007-2014) GDP has stagnated in the euro zone. This dismal performance has been compounded by significant disparities between the largest countries: a deep slump in Spain followed by a modest recovery, persistent recession in Italy, a bumpy track in France with hopes of sustained recovery repeatedly disappointed, and moderate growth in Germany despite flat domestic demand, due entirely to its huge trade surplus (around 7% of GDP in 2013).

Broadly speaking, the euro zone can be said to have caught a disease called “*secular stagnation*”, empirically defined (Teulings & Baldwin, 2014) as GDP per capita growth between 0% and 1% for a prolonged period of time. We see the primary cause of this disease as being the severe lack of willingness to invest. Productive investment in the private sector fell by about 20% overall in the euro zone between 2007 and 2014 (IMF, 2014). Meanwhile, private saving surged, spurred by the desire to deleverage and the fear of an uncertain future increasing the preference for liquidity. The result is a huge gap between gross national savings and gross domestic investment (see Figure 2). IMF (2014) does not foresee much improvement before the end of the decade.

Figure 1.



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