TE TAI ŌHANGA
THE TREASURY

Financing the transition to a low emissions, climate resilient economy

Speech to the Financing and Investment session at the Climate Change and Business Conference, Auckland by

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Tēnā koutou katoa

I am delighted to have the opportunity to speak with you today about the important topic of financing the transition to a low emissions, climate resilient economy.

The Treasury is the Government's lead economic and financial advisor, and our goal is to lift living standards for all New Zealanders. Climate change is an existential threat to those standards.

Devastating effects of severe weather are being felt now, here in New Zealand and around the world. Human, social, environmental and economic disasters will intensify without urgent and sustained action to cut emissions and adapt to our new environment.

Responding to climate change means structural change in our economy. Whether it's electrification of transport and industry, changed transport modes, low emissions agriculture, more efficient city and building design in lower risk locations—we will see shifts that profoundly shape every part of our economy and society.

Financing the climate transition is a mammoth task. New Zealand's Climate Change Commission estimates $34 billion of additional investment across key areas of the economy is needed by 2035.[1] On top of these domestic costs the Treasury estimates that meeting the international commitments under the Paris Agreement through our Nationally Determined Contributions could require up to $12.8 billion in overseas mitigation by 2030. And as just one signal of adaptation costs, with 60cm of sea level rise, 94,000 buildings worth $26 billion would be exposed to coastal flooding.[2]

1 Climate Change Commission analysis.

2 NIWA. 2019. Coastal Flooding Exposure Under Future Sea-level Rise for New Zealand.

Globally, the International Monetary Fund estimates $USD3.3 trillion per year to 2030 in energy investments, and a quarter of a percent of global GDP per year in public adaptation costs is needed in coming decades.[3]

Consensus is growing that early adjustment means lower overall costs. For business, action now reduces the risk of stranded assets or capital constraints. Investors, lenders and insurers are getting better at capturing and pricing climate risk, and simply won't put their money in some activities they have historically.

I want to stress, however, that the climate transition presents opportunity as well as cost. New Zealand has a high share of renewable energy, and high potential for carbon removals. Climate-friendly activity could provide better access to capital at attractive pricing. Low emissions and climate-resilient technologies will bring new investment possibilities, growth in new sectors, export opportunities—and can make New Zealand an even more attractive place for global financial and human capital.

Sustainable finance

Our finance system lies at the heart of the climate transition. At the Treasury, our vision is that our finance system can take into account all of the things that matter for our living standards. The Treasury's Living Standards Framework and Māori wellbeing framework, He Ara Waiora, recognise that while a strong economy is central to lifting living standards, material wealth is not all that people care about. We also seek healthy lives, education, a clean environment, strong and safe communities, now and into the future. Growing our financial wealth today is of little value, for example, if it destroys our natural capital and living standards for future generations.

Applying the Living Standards Framework to our finance system means we need to measure what matters, and to enable decision-makers (public and private) to take wider, and intergenerational factors into account when they direct their resources.

Investors are increasingly taking this broader approach. The sustainable finance market is small now but growing. In New Zealand sustainable bond issuance has grown more than 40-fold, from $125 million in 2017 to $5.6 billion in 2021.

It's likely that one day, we will simply speak of "finance" not "sustainable finance." More rigorous reporting on a broader set of costs, benefits and risks—including climate—will be standard. Investors and lenders can then put their money towards the returns and risks that they value on the basis of a more robust assessment.

Among other implications, sustainable finance means enabling climate to be considered in every financial decision. We will not reach net zero emissions or adapt to climate change unless we shift our resources to low emission, climate resilient activity.

[3] Kristalina Georgieva. 2022. Climate-Related Financial Risks and Green Finance in Asia and the Pacific.

This isn't the work of just the public sector or the private sector or the social sector. It's the work of all of us together. It will take coordination, collaboration and partnership to mobilise capital on the scale and at the pace we need.

Many businesses here are taking great strides to cut emissions and build climate resilience. We see encouraging developments in the finance sector, and I'm looking forward to learning more in the panel discussion.

At the Treasury, we view our role as being to help Government to get the settings right and making them clear and predictable. We want to remove barriers that prevent you doing what you do best. Getting it right as a nation will translate to a finance sector that is transparent, efficient, agile, informed and resilient.

I'd like to highlight three key elements that we see as critically important to drive this vision:

- Ensuring that market signals to businesses and consumers align with our climate targets
- Clearly articulated standards and rules on climate information architecture, that drive better climate-related measures, require the use of those measures in financial decisions, and support transparent disclosure of those measures
- The role of government as a market catalyst, including providing leadership in how government manages its own finances

1 Market signals

Humanity has spent centuries emitting greenhouse gases into the atmosphere without fully incorporating this cost into our investment, financing and business decisions. Even today, emitters face a price for only 23% of global emissions[4]—although humanity is bearing the full cost.

In New Zealand, we took steps towards recognising this failure in 2008 with the establishment of our Emissions Trading Scheme (ETS). The ETS is the cornerstone for aligning capital with the climate transition. It sets a price for greenhouse gases, making low emissions investments more attractive and shifting incentives away from high emissions activity.

Recent amendments to the ETS mean it now delivers a stronger signal for emitters to consider the full costs of the greenhouse gases they produce. Today the price of a tonne of CO2 is $83, more than double the price only 2 years ago.

Full recognition of the costs of emissions across our economy requires pricing 100% of our emissions. Today, 52% of our economy's emissions face a price, with the notable exception being agricultural emissions. Efforts are currently underway to price agriculture emissions by 2025. In our view at the Treasury, this is a critical step towards our climate targets. We need a meaningful signal that sets incentives for low emissions land use and agricultural practices.

[4] World Bank State and Trends of Carbon Pricing 2022

Efforts underway to better capture emissions removals in the ETS, as well as support the development of robust voluntary carbon markets, are also critical. We need to recognise that emissions offset integrity needs strengthening and to fix that. Tackling climate change means reducing net emissions. We need choices to offset emissions through high integrity emissions removals—like planting forests, restoring peatlands, riparian zones and shrubland.

Without doubt we require far fewer emissions to be produced—that is, cuts in gross emissions. But as we decarbonise, we come to a state where the economic cost of decarbonising gets greater and greater. Using high integrity offsets, especially between now and when we have better and cheaper technologies to address those hard-to-abate emissions can help us achieve our targets, keep global warming down and keep our costs down so we can support our broader wellbeing objectives as well.

2 Setting standards and rules

Emissions pricing is one of the most important and powerful signals to support financing of our transition to a low-emissions, climate resilient economy. However, as we all know, markets have their limits. While emissions pricing addresses one key market failure, there are more—from information gaps to public goods. Also, relying on emissions pricing alone can raise concerns of fairness and equity.

If we are to accelerate change to meet our climate targets while also supporting an equitable transition, getting the settings right for the finance sector means complementing emissions pricing with other measures. Such policies can help remove information barriers, ensure our regulatory system is fit for purpose to support effective climate investment and ensure that public goods such as research and development can deliver the technological change needed.

Often non-spending tools such as well-targeted regulations and broader system settings can be as, if not more, effective in unlocking and channelling private capital towards the outcomes we are all looking for and away from the outcomes we aren't.

The main example I want to highlight today is rules and standards on information architecture—one of the most important foundations for climate finance. Markets need information to work effectively. Common taxonomies and standards that require businesses to capture a wide range of climate-related measures, use them in their business decisions, and disclose them can enable financial markets to make informed choices about risks and opportunities—on both mitigation and adaptation.

New Zealand was the first country to announce mandated climate-related disclosures, following the Taskforce on Climate-related Financial Disclosures (TCFD) framework. Another seven have since followed. The practical impacts are that from year-end reporting in 2023, around 200 large New Zealand organisations will start disclosing clear and comprehensive information on the impacts of climate change—relating to governance, strategy, risk management, and metrics and targets.

It’s a significant development in reporting requirements, which to date largely focus on traditional financials and risks. At the moment, it is hard for businesses, their investors and customers to get quality information on how climate impacts their bottom lines. Mandating disclosure of climate risks and opportunities means that market participants are better able to make the “green” or “climate-resilient” choice. This will help orient investment and spending to low emissions and climate-resilient activity.

If climate-related measures and disclosures are not already well under development by businesses here, I suggest they need to be. Investors and other stakeholders will be expecting this information. Ultimately robust understanding of what these measures mean for your business can be a key determinant of success or failure in an increasingly climate-focused economy.

On top of growing demand for climate disclosures, capital providers and consumers are increasingly scrutinising the authenticity of sustainability information and seeking assurance of its integrity. Misleading information – or “greenwashing” – is more difficult with standard taxonomies, mandated disclosures and official guidance and frameworks. Oversight is growing. For example, the Financial Markets Authority has released guidance to help protect investors in sustainable (or integrated) financial products from greenwashing.

Better information is also being used to increasingly support the pricing of climate risk by investors and insurers. As this understanding continues to grow and methodologies for pricing this risk continue to improve, anticipate seeing these disclosures increasingly support our response to adaptation as much as mitigation.

Beyond standards on information architecture, there are a range of other rules and regulations tilting financing decisions towards climate goals, from vehicle emissions standards to prudential requirements. It’s not all about government rules either—for example industry standards on green buildings are improving transparency on environmental impacts of buildings and helping consumers and financial markets to make the climate-friendly choice.

3 Government’s role as a market catalyst

Finally, government can also support climate finance as a market catalyst, through how it takes climate into account in managing its own finances—from spending and revenue decisions in Budgets, to stewardship of the Crown balance sheet, and its own climate-related disclosures.

New Zealand has made progress in each of these areas:

Embedding climate in the Budget

A major development in Budget 22 was the establishment of the Climate Emergency Response Fund (CERF) with an initial value of $4.5 billion. The CERF recycles ETS proceeds in an enduring, multi-year fund for government spending on the climate transition. It complements the ETS by enabling direct investment in initiatives that ETS price signals may not achieve—for example public goods like research and infrastructure or addressing equity considerations.

The multi-year nature of the CERF provides more certainty of funding, which encourages long-term planning on actions we need now in order to achieve a less costly transition over time and get the system transformation we need. The Treasury is building in transparent monitoring and evaluation to support CERF investment to deliver its highest value.

Of particular importance for this audience, Government has also chosen to fund initiatives from the CERF that will directly support business in financing the transition. This included support for businesses to upgrade to more energy efficient equipment, and a $650 million boost for the Government Investment in Decarbonising Industry Fund (or GIDI), which partners with process heat energy users and provides targeted funding to help accelerate industry's switch to cleaner energy sources.

Embedding climate in the budget is not just about directly funding climate initiatives. The Treasury is working to take a climate lens to all budget proposals. We include a "shadow emissions price" in our cost-benefit analysis guidance, to capture the emissions impact of new spending, and are incorporating climate considerations in our business case guidelines and capital project evaluation.

By applying the Living Standards Framework and He Ara Waiora in our value-for-money assessment of budget proposals, we aim for a more rigorous analysis of all costs, benefits and risks, including those that are climate-related.

Climate-related stewardship of the balance sheet

Beyond the Budget, Government can also catalyse climate finance through the management of its balance sheet. Last week saw a milestone in this direction with the launch of the NZ Sovereign Green Bond Programme, ahead of the Treasury's inaugural Green Bond issuance planned for later this year.

The Green Bond programme is not about new or more debt. It gives investors the opportunity to finance high value public sector climate and environmental projects. It helps to ensure these projects are undertaken and well executed, as well as drive market best practice in monitoring and reporting on climate expenditure outcomes. In doing so, it can support the development of New Zealand's sustainable finance market.

Experience from other jurisdictions shows that interest in sovereign green bonds is high and can drive increases in the private green bond market. There is also potential for a "greenium," or lower yields, although the evidence is mixed, and the market is evolving rapidly.

The New Zealand green bond framework released last week sets out the expenditure categories that New Zealand's Green Bonds will finance, including Clean Transport, Green Buildings and Biodiversity, among others. The Treasury envisages ongoing issuance of green bonds and, over time, increased transparency and reporting around climate, sustainability and living standards for the entire government debt portfolio.

On the other side of the balance sheet, the Green Investment Fund – New Zealand's green investment bank – is mobilising the government balance sheet to "crowd in" private capital to accelerate and facilitate investment in decarbonisation. And the Crown Responsible Investment Framework released last year aligns the government's investment portfolio (which is expected to grow to $500 billion by 2050) with New Zealand's climate targets. Crown Financial Institutions are measuring their investment portfolio carbon footprints, reducing their portfolio net emissions to zero by 2050, and supporting the transition to a low-carbon economy by seeking investments that generate additionality. This comprehensive approach to investment management is one increasingly taken by the private sector, which we will hear more on soon from the panel.

Measuring and disclosing climate-related impacts

Finally, better climate-related measures and disclosure in the public sector can help direct capital towards climate goals and support private climate finance. Mandated climate disclosure standards do not currently apply to the Crown. But work towards embedding the principles is well underway.

We have an important stewardship role at the Treasury to support transparency on the fiscal and economic impacts -risks and opportunities - of climate change. Our long-term fiscal statement released last year outlined the many channels by which climate change will affect the Crown's fiscal position. We presented illustrative scenarios showing how more frequent droughts and storms could add almost 4% of GDP to net debt. Our Wellbeing report, to be released in November this year, will examine climate change as one of the central risks to living standards.

The Treasury will build on this work later this year when, in collaboration with the Ministry for the Environment, we will publish a report specifically on the fiscal and economic impacts of climate change including a range of scenarios and risks. We expect there to be plenty of gaps in our understanding of these right now—but the goal is that we will continue to develop these disclosures over time in a way that better informs decisions on climate risk and opportunity across our economy.

In closing

Here in New Zealand we have taken significant steps towards ensuring our tamariki and mokopuna get the opportunity to grow up in a healthy environment and improve their living standards, just as we did. However, we still have a lot more to do to secure that future.

Transitioning to a low-emissions, climate resilient economy requires a financial system that takes into account a wider set of measures of living standards (providing a more rigorous analysis of <u>all</u> costs, benefits and risks of financial decisions). It means considering climate in every financial decision.

We need to support capital providers with the incentives, knowledge and the confidence to undertake the investments needed to reduce our net emissions and increase our climate resilience.

It is encouraging to see the acceleration in sustainable financing globally. (We'll learn more about this from our panel shortly.) There are big opportunities and there is an urgent imperative. The direction is clear. Our challenge in the Treasury, and my challenge to all here is: are we accelerating the pace of change fast enough?

No reira, tēnā koutou, tēnā koutou, tēnā koutou katoa.

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