

Active is:

Accelerating economic growth through sustainability

MAY 2019

European Union aims towards accelerating economic growth through sustainability

By AllianzGI Global ESG Strategy Team ¹



Dr. Steffen Hoerter
Global Head of ESG
Member of the EU TEG



Glenn Oliver Anderson
Global ESG Investments

We stand at the crossroads of European Union's (EU) sustainability strategy that is full of turning points with important implications for investors. In its recent reflection paper the European Commission (EC) highlights that it envisions strong future EU economic growth through sustainability transformation and business innovation.²

The EC aims to win GDP Growth and Sustainability in tandem and estimates an annual finance need of EUR 270bn for Climate, Energy, and Water alone. The potential global benefits have been estimated to unlock USD 26tn of economic value through new jobs, well-being, and competitiveness.³ Question remains which economy will snap up the most of it?

In this Environmental, Social, Governance (ESG) economic research, we summarise the key EU targets for the Sustainable Europe Agenda. We start with an overview about the sustainable development's status quo in the EU and put out the key questions. Then we lay out three potential future EU sustainable development policy scenarios. As an outlook we highlight the opportunities for the EU on globalization of sustainability to win the international race to be the first true sustainability leader.

European Commission's reflections for Sustainable Development

In a recent 2019 reflection paper, the Commission sees the UN Sustainable Development Goals (SDGs) as a compass to achieve prosperous future economic growth in the EU.

Expectations are set high in business success by sustainability innovation and transformation of sectors and corporates. Complex environmental challenges require new technology

and business solutions, especially, as the EU is also sensitive towards the large societal challenges that a rapid sustainability transformation will bring with potential short term costs to its citizens and corporations.

Internationally, the EU's SDG reflections also discuss how sustainability could exert more strategic independence and be exported globally.

Ideas to stimulate successful growth via Sustainable Development innovation and investments

How can the EU economy capture its slice of business, and investors contribute to financing the USD 6tn per annum to reach the 17 SDGs until 2030? In our view, the responsibility to commercialize this opportunity lays primarily with the private sector, with EU crucially supporting and accelerating this change. For this, a clear political direction with set policy and economy targets by the EU is desired.

Access to capital and investment opportunities is key. For example, we think joint private-public partnership (PPP) desks with active investors can critically bridge SDGs closer to long-term investors via a much larger scale of project flow. To achieve these, the EU could promote more sustainable investment knowledge innovation communities (KICs).³ Long-term investors, such as pension funds and insurers will be central.

³ Of great example are the Climate-KIC initiative and Potsdam Institute for Climate Impact Research, which have helped to foster innovation that is necessary to tackle climate change. German readers might also find of interest the article by Prof Hans Joachim Schellnhuber in Perspektive "Einbindung institutioneller Investoren in nachhaltige Lösungsstrategien"

Sustainable Development in the EU ⁴

	EU Aspirations	EU Status Quo
Economic Growth	<ul style="list-style-type: none"> Maintain and increase the economic growth in the European Union 	<ul style="list-style-type: none"> Economy in the Environmental sectors has far outpaced the Total Economy growth, both in terms of Value Added and Employment as seen in Chart 1
Climate Transition	<ul style="list-style-type: none"> 2030: Reduction of Greenhouse Gas (GHG) emissions by min. 40% vs 1990 2050: Net-zero GHG emissions 	<ul style="list-style-type: none"> Emissions in the EU-27 have been reduced by 23% ⁵ out of the 40% necessary. In the next EU budget, 25% are to be used for climate objectives, 12% of the budget will be from sustainable resources. ⁶
Energy Mix	<ul style="list-style-type: none"> 2030: Renewables share of 32% in end-use of energy 2050: More than 80% of electricity to originate from renewable energy ⁷ 	<ul style="list-style-type: none"> EU is on track to meet its 2020 goal of 20% energy from renewables (currently – 17.5% ^{8a}) EU is the global leader for Renewable Energy per capita. Currently 55% of the gross EU energy consumption is imported, and only 0.35% of it is from renewable sources ^{8c} EUR 55bn ² p.a. of energy subsidies in the EU are still going towards coal and carbon sources
Energy Efficiency	<ul style="list-style-type: none"> 2030: Lower Energy consumption versus 1990 by min. 32.5% ⁷ 	<ul style="list-style-type: none"> Energy use in the EU-28 still must be reduced by more than 34% Currently total EU energy consumption is 2% higher than in 1990 ¹¹
Sustainable Agriculture	<ul style="list-style-type: none"> With EUR 79bn of the EU budget allocated to agricultural rural development, at least 30% have to be spent on climate measures. ⁹ 	<ul style="list-style-type: none"> Organic Farming has increased by 25% in the last 5 years 45% of EU agricultural soil is still poor organically ²

Chart 1
Change in GDP and Employment of Environmental Economy versus the Total Economy in EU-28 ^{8b}

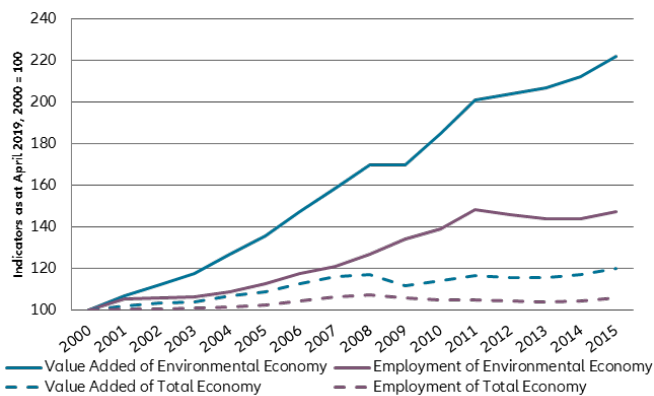
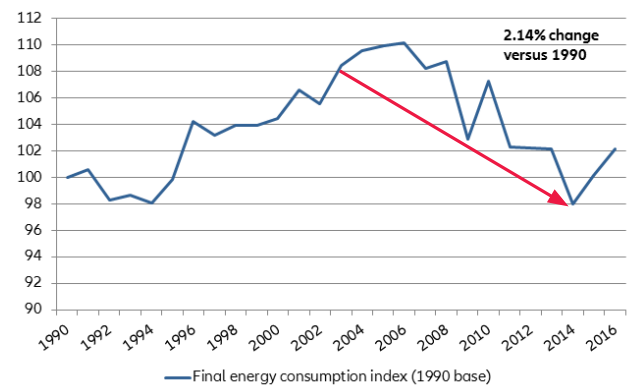


Chart 2
Energy consumption in the EU-28 from 1990 to 2016 ¹⁰



¹ The views and opinions expressed in this paper, which are subject to change without notice, are those of the author, Global ESG Strategy Team, at the time of publication and do not necessarily reflect the opinion of the issuer and/or its affiliated companies.

² European Commission, Reflection Paper Towards Sustainable Europe, 2019.

³ Garrido, L., Fazekas, D., Pollitt, H., Smith, A., Berg von Linde, M., McGregor, M., and Westphal, M., 2018. Forthcoming. Major Opportunities for Growth and Climate Action: A Technical Note. A New Climate Economy contributing paper.

⁴ We leave out of the analysis other sustainable development themes, such as, education, poverty, etc, due to the EU already being one of the leaders in these fields or due to the developing methodologies about their measurement

⁵ European Commission, Two years after Paris – Progress towards meeting the EU's climate commitments, 2017

⁶ European Commission, The Multiannual Financial Framework for 2021-2027

⁷ European Commission, A Clean Planet for all, A European strategic long-term vision for a climate neutral economy, 2018

⁸ Source: Eurostat a) nrg_ind_ren b) env_ac_egss2, env_ac_egss1, nama_10_gdp, nama_10_pe c) Energy Balances

⁹ European Commission, EU Budget: the Common Agricultural Policy after 2020

¹⁰ Source: Eurostat (nrg_110a)

The turning points still in need of clarification on Sustainable Development in the EU

If the EU see SDGs as a general indicator for the direction of the economy then investors seek answers to:

- How can **sustainability technology** innovators find a better access to private sector investment?
- What incentives could be given to small, mid and large caps corporates to **innovate** sustainable services and products with the direction to transform business models?
- How does the EU plan to improve the accessibility/ **supply of SDG-related investments for private investors**?
- **Public-Private Partnerships (PPPs)** work - what more roles can they play, e.g. European Investment Bank, European Fund for Sustainable Development, or the European Fund for Strategic Investments?
- Fiscal policy is a powerful tool for policy objectives – how can **sustainability driven fiscal policy** be leveraged better to achieve global sustainability aims? Should the Finance Ministry Coalition for Climate Action be expanded further?

For addressing these sustainability challenges we outline three potential policy scenarios that may define the Sustainable Europe agenda from an investment perspective going forward.

1 EU takes a soft economic and policy approach to promote Sustainable Development

In this case, the EU would not interfere much into the private sector activities, if at all. Consequently, the required sustainability innovation and economic transformation would be completely **put on the shoulders and appetite of the private sector**.

This could be beneficial in avoiding free-rider issue and unintended consequences, through market distortion via subsidies. But it risks the Sustainable Europe agenda being too slow, or opportunities being overlooked by the private sector, potentially leading the EU to fall behind on sustainability akin to falling behind on other new technologies such as Artificial Intelligence.

2 EU gives a principles-based sustainability guidance and provides support

“Instead of asking what should be regulated, we must ask what can private investment achieve without regulation already”

The EU preferably could engage as a supporter of the economy’s sustainability transition. While more clarity on the EU’s policy and economics targets is wanted, it could reach sustainability equilibrium **by guidance, collaboration, and support**. For example, setting a carbon price instead of directing how to assess carbon risk.

Such action could create a prosperous eco-sphere for matching sustainability driven business innovation with the investor’s demand for attractive long-term investment opportunities. Active investors should be supported to target the opportunities set by true Sustainable Business innovation in creative Research & Development solutions.

It does take at least two to dance the sustainable development tango. Thus, if the EU was to facilitate it, for example by PPPs and KICs, it would also be important for corporates, start-ups, and investors to take part. Through the **EU Sustainable Finance Action Plan**, the EU has addressed key components to sustainable investing (Taxonomy, Green Bonds, Climate Benchmarks, EU Ecolabel for green financial products). A leap-frog in mainstreaming could possibly be achieved beyond a green impact investment focus to a broader impact focus that includes many more of the 17 SDGs.

3 EU strongly pushes for innovation in Sustainable Development and adoption within the economy

Large subsidies and financial support from the EU towards sustainable development themed businesses would be expected if this policy scenario was to come to fruition. To incubate innovation and growth, the EU would have to re-channel subsidies from “the old economy” e.g. thermal coal, into “the new economy” with a focus on sustainability targets. Additionally, new fiscal mechanisms could be introduced such as a carbon tax and dividend scheme for the EU – similar to what is promoted by the Carbon Pricing Leadership Coalition and has been endorsed by over 2,500 leading US economists spearheaded by former US Federal Reserve chair Janet Yellen.¹¹

This will attack the time paradox inherent in most sustainability challenges such as climate change where immediate action is required while there may be no or very limited market incentive to innovate and invest. On the downside, there is a risk of free-riding, lack of true innovation and public discontent due to taxpayers footing the bill as well as administrative complexity being perceived as too much “red-tape”.

¹¹ Carbon Pricing Leadership, <https://www.carbonpricingleadership.org>

Global Race to Sustainability - The future outlook on the international sustainable development

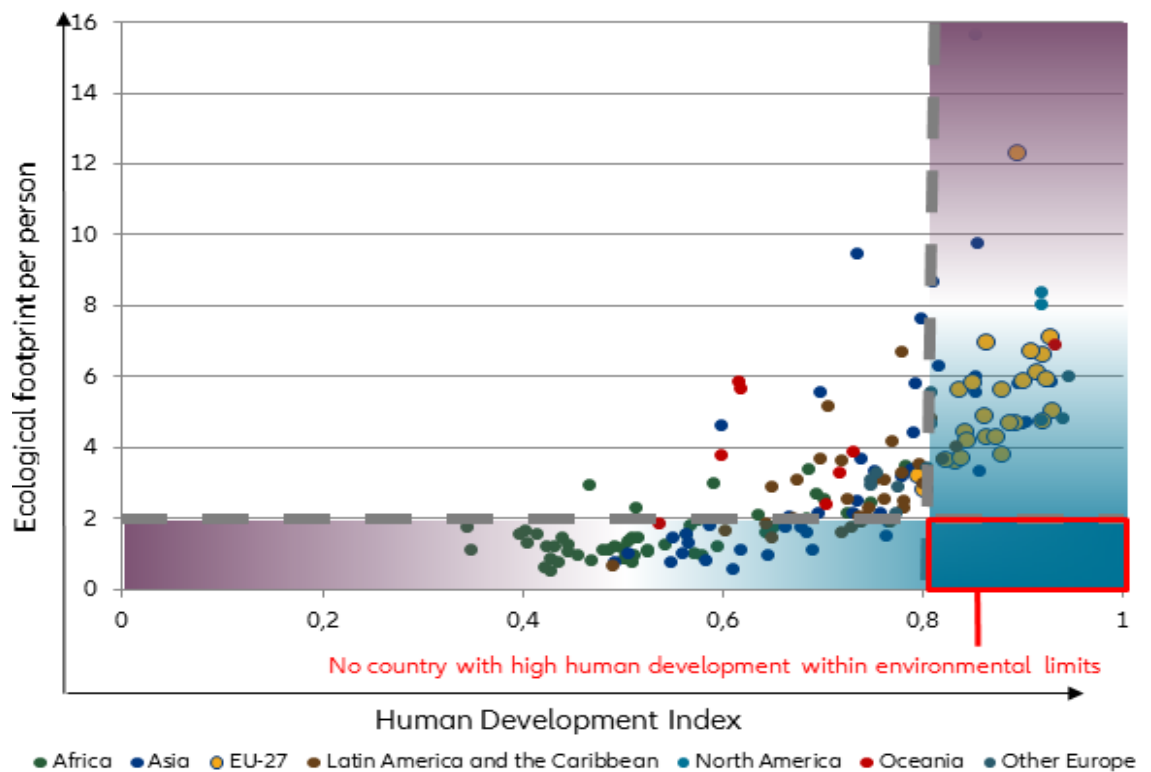
If the EU will be successful as a global leader in sustainability technologies and innovation, including sustainable finance standards and solutions, then sustainability as a trade commodity has the option to lift the EU GDP growth even further as a global export and a trailblazer success. There could also be positive effects via the Generalised System of Preferences through more trade policies and Foreign Direct Investment opportunities in countries also endorsing sustainability, which attracts back to the EU economy.

On the financial standards side, a comparison to be drawn here is the increasing international adoption of International Financial Reporting Standards (IFRS), which were pushed forward by the EU.

In the mid-term, the EU collaboration with China and other countries about sustainability is important for investors, especially if joint standards were developed to ease cross-border investments and joint ventures around sustainability themes and issuer listings for green finance for example. In the long-term, the EU's global sustainability role can shift due to Africa, e.g. the new Africa-Europe Alliance for Sustainable Investment and Jobs may present new and previously unseen investment opportunities.

In the global race, for the EU to become the leading sustainability economy that achieves high GDP growth and a balanced sustainable ecological footprint (as shown in **Chart 3**) the jury is out and the stakes are high. **The EU has a good starting position but must make the right calls soon.**

Chart 3 Countries' ecological footprint in relation to Human Development: A race to be first¹²



¹² Data Human Development Index and Global Footprint Network as at 2014 (latest date available)

Investing involves risk. The value of an investment and the income from it will fluctuate and investors may not get back the principal invested. Environmental, Social and Governance (ESG) strategies consider factors beyond traditional financial information to select securities or eliminate exposure which could result in relative investment performance deviating from other strategies or broad market benchmarks Past performance is not indicative of future performance. This is a marketing communication. It is for informational purposes only. This document does not constitute investment advice or a recommendation to buy, sell or hold any security and shall not be deemed an offer to sell or a solicitation of an offer to buy any security. The views and opinions expressed herein, which are subject to change without notice, are those of the issuer or its affiliated companies at the time of publication. Certain data used are derived from various sources believed to be reliable, but the accuracy or completeness of the data is not guaranteed and no liability is assumed for any direct or consequential losses arising from their use. The duplication, publication, extraction or transmission of the contents, irrespective of the form, is not permitted.

This material has not been reviewed by any regulatory authorities. In mainland China, it is used only as supporting material to the offshore investment products offered by commercial banks under the Qualified Domestic Institutional Investors scheme pursuant to applicable rules and regulations. This document is being distributed by the following Allianz Global Investors companies: Allianz Global Investors U.S. LLC, an investment adviser registered with the U.S. Securities and Exchange Commission; Allianz Global Investors Distributors LLC, distributor registered with FINRA, is affiliated with Allianz Global Investors U.S. LLC; Allianz Global Investors GmbH, an investment company in Germany, authorized by the German Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin); Allianz Global Investors (Schweiz) AG, licensed by FINMA (www.finma.ch) for distribution and by OAKBV (Oberaufsichtskommission berufliche Vorsorge) for asset management related to occupational pensions in Switzerland; Allianz Global Investors Asia Pacific Ltd., licensed by the Hong Kong Securities and Futures Commission; Allianz Global Investors Singapore Ltd., regulated by the Monetary Authority of Singapore [Company Registration No. 199907169Z]; Allianz Global Investors Japan Co., Ltd., registered in Japan as a Financial Instruments Business Operator [Registered No. The Director of Kanto Local Finance Bureau (Financial Instruments Business Operator), No. 424, Member of Japan Investment Advisers Association and Investment Trust Association, Japan]; and Allianz Global Investors Taiwan Ltd., licensed by Financial Supervisory Commission in Taiwan.