

Governing Green Finance

Bert Scholtens
Department of Finance
University of Groningen



Outline

* Focus is on financing arrangements to promote the environmental and ethical quality of our society

- Background
- Case
- Governance
- Conclusion



Background

- Finance and the Economy
 - Banks and other intermediaries screen and select alternative investment projects. They incur a fraction $1-\phi$ in this process.
 - Information production and diversification opportunities by financial intermediaries improve marginal social productivity of capital.
 - Intermediaries affect the savings rate.



Background

- Financial intermediaries are perfectly equipped to assess investment projects.
- Selection process green finance:
 - Negative selection: do not consider lending to or investing in projects with particular attributes, such as tobacco, gambling, weapons, nuclear.
 - Positive selection: do consider firms with particular attributes; pick the best in class w.r.t. their performance on different characteristics (problem: how to weigh the attributes, ranks)

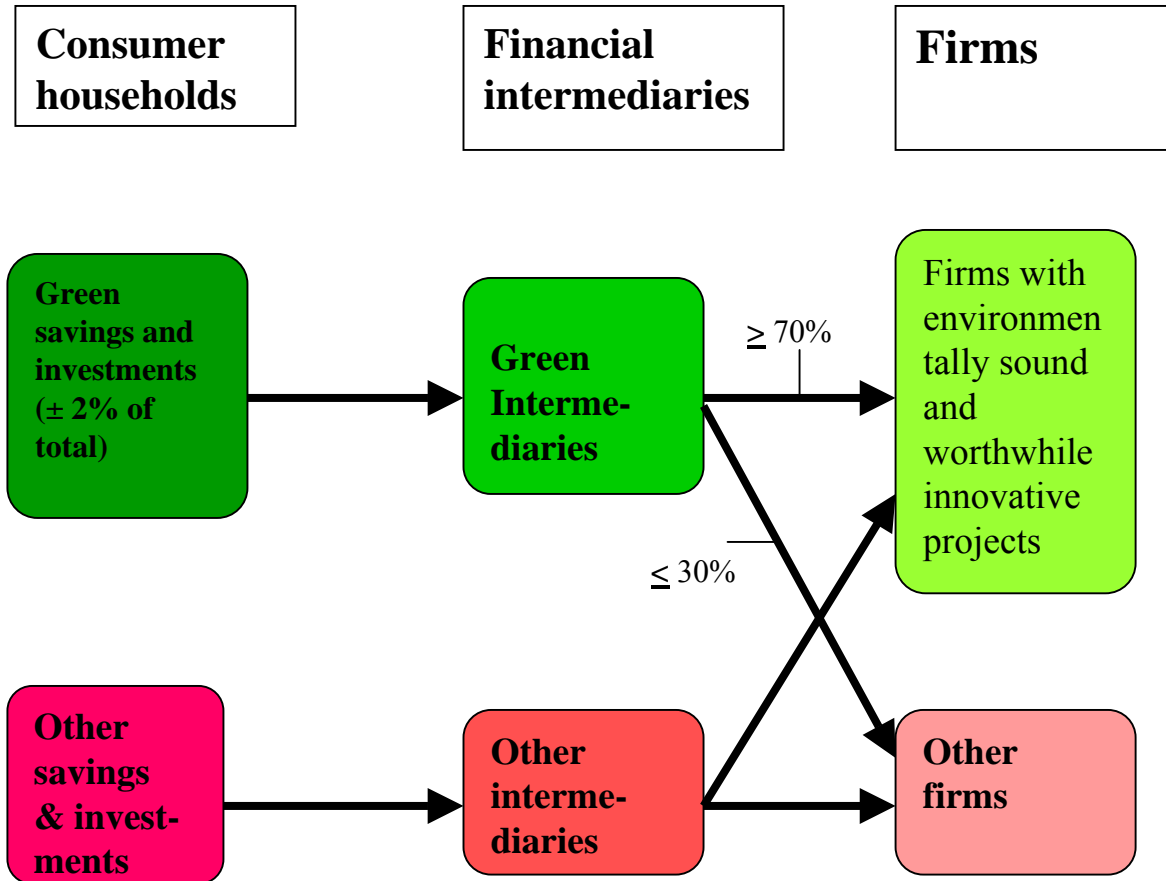


Case: Green Project Facility

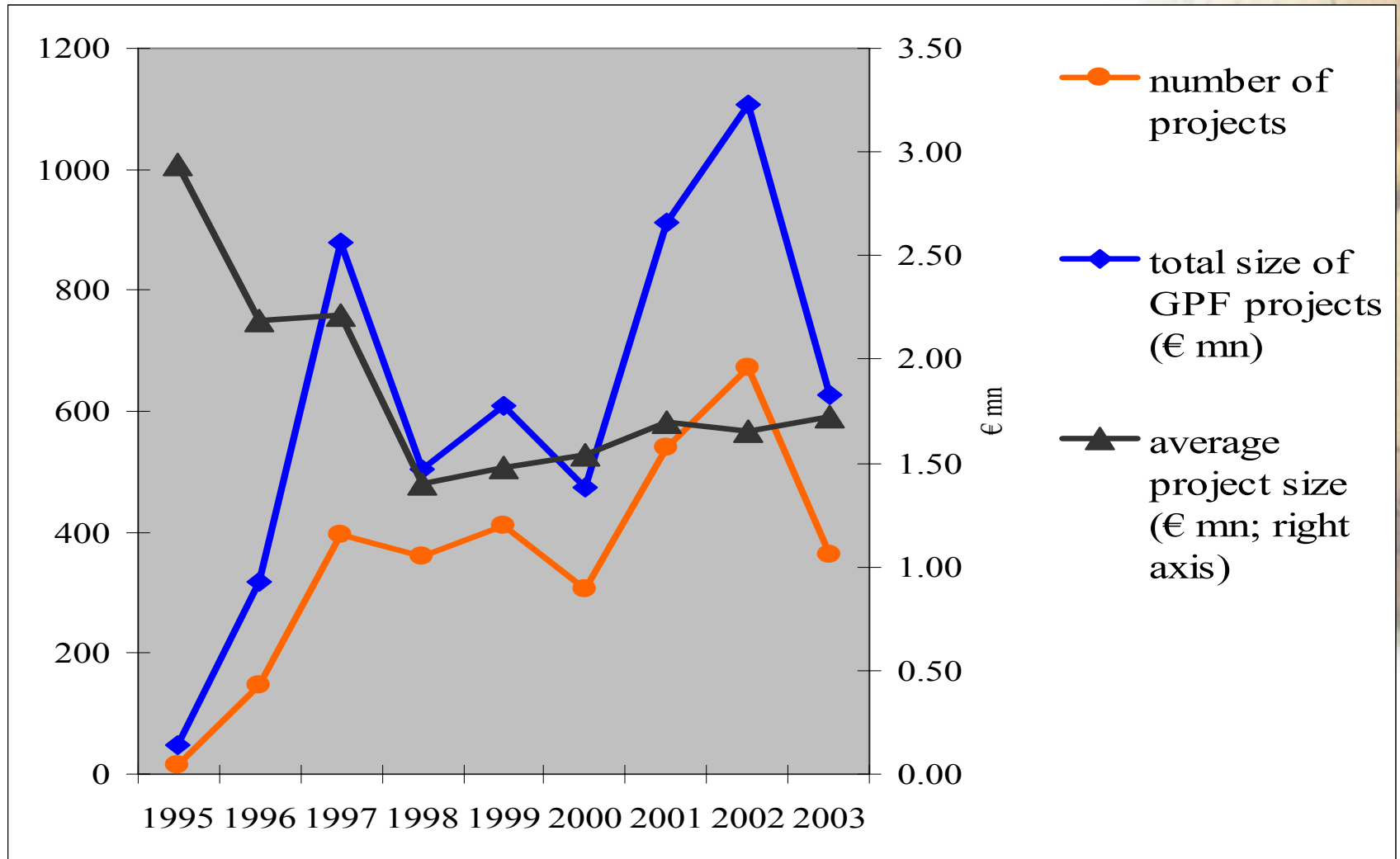
- Government tax incentive instrument.
- In use since 1995 to promote environmentally friendly initiatives and to raise consumer awareness.
- Private households lend money to Green Banks at a lower interest rate, which is compensated by a tax subsidy.
- Green Banks offer cheaper loans to government-certified environmental projects.
- Examples: organic farming, renewable energy, sustainable residential construction.



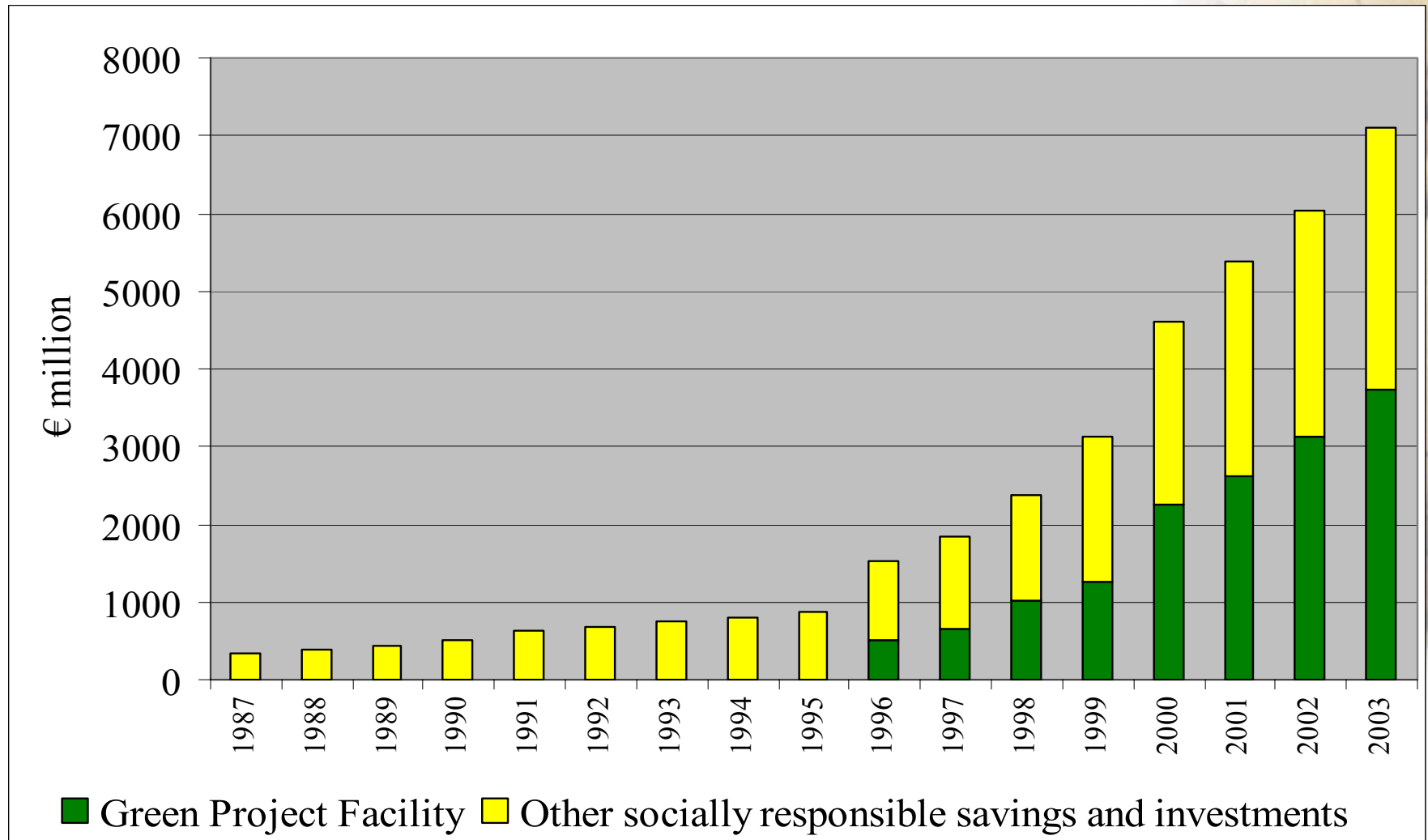
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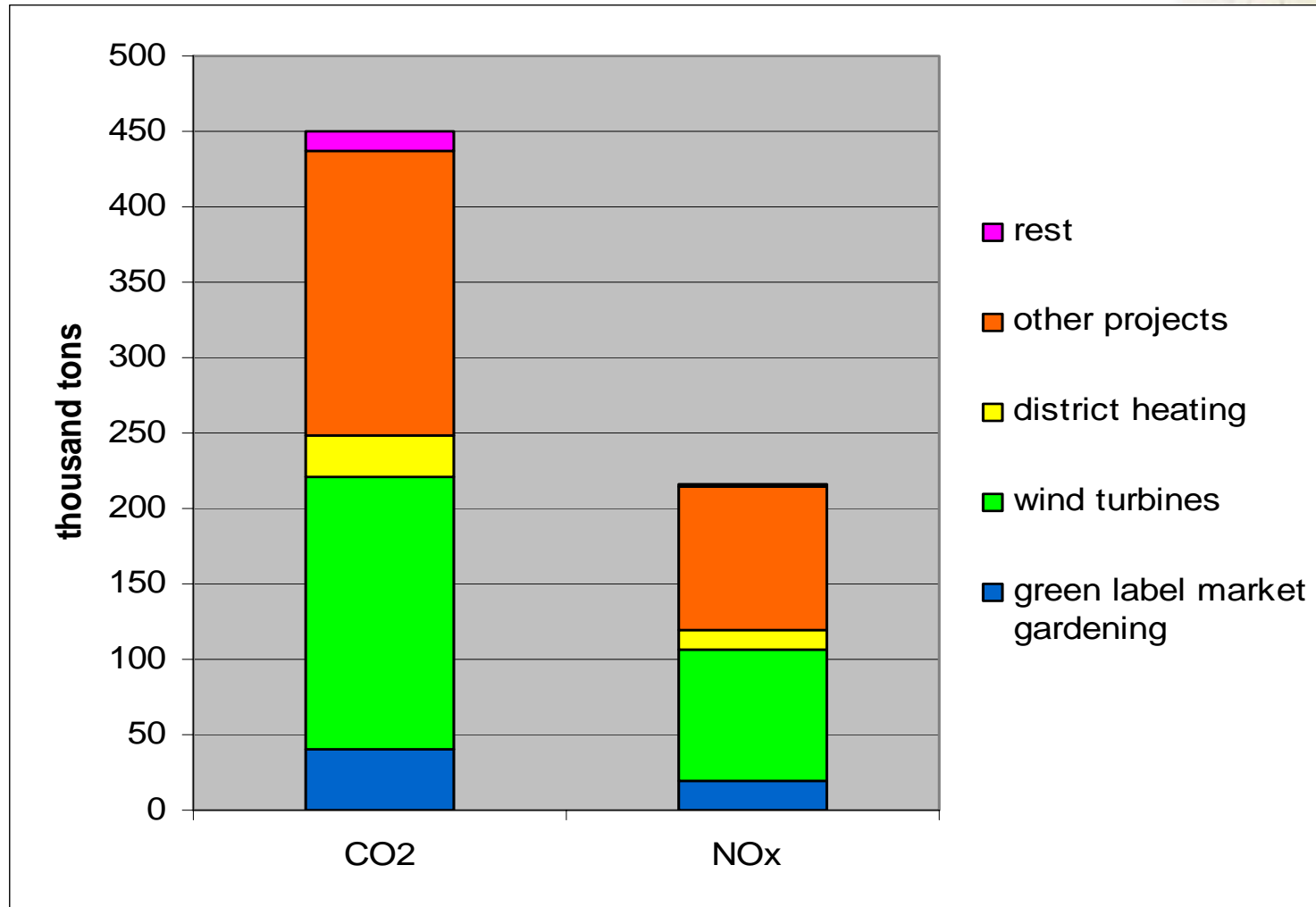


Case: Green Project Facility

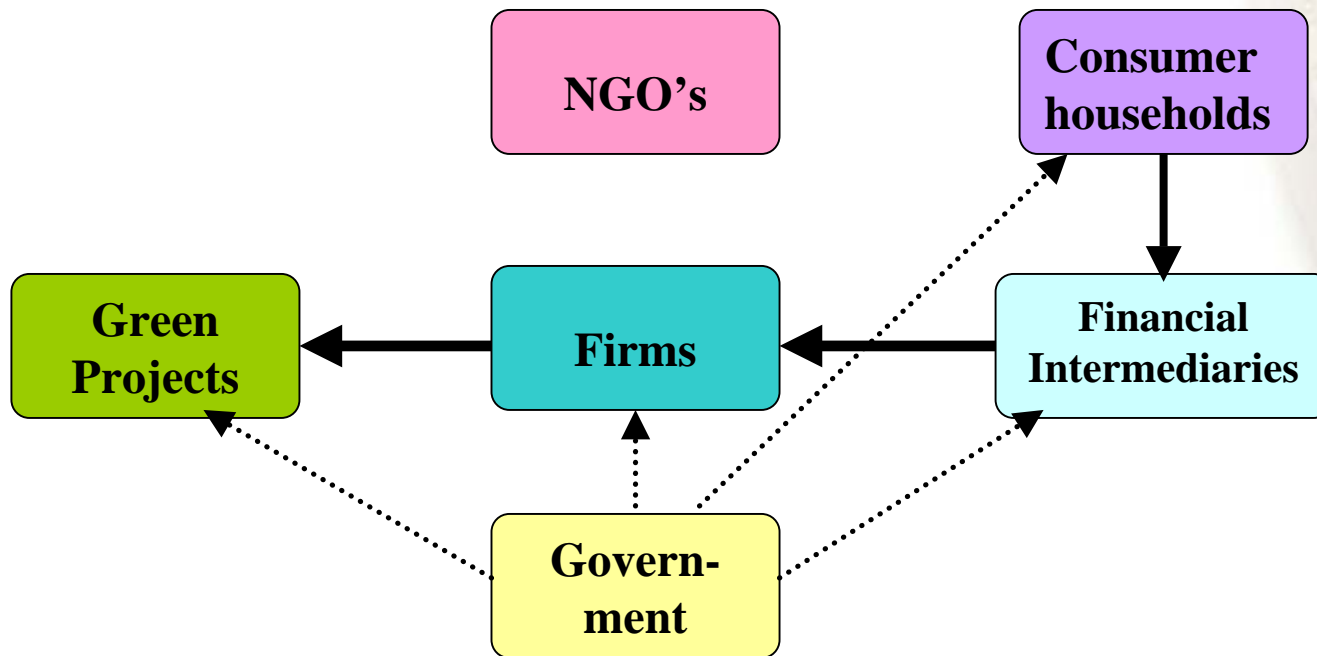
- **Economic:** employment, value added; part of the projects would have been undertaken anyhow.
- **Tax:** less income & dividend taxes, more VAT, corporate taxes.
- **Financial system:** concentration implies vulnerability.
- **Environment:** complementary activities, hardly substitutes. Average production 'cleaner' but overall burden on the environment still increases.



Emissions Prevented by Green Projects 2003

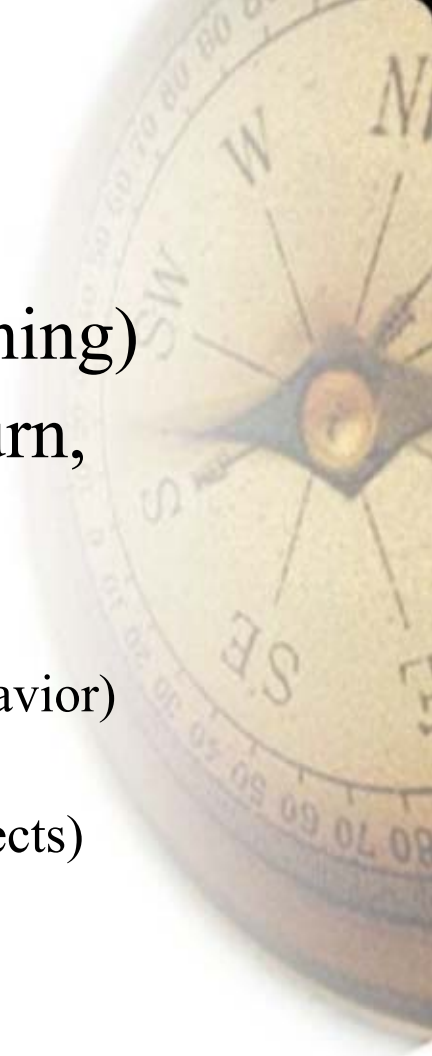


Governance: Stakeholders



Governance: Stakeholders

1. Firms (realize projects, return, positioning)
2. Intermediaries (generate turnover, return, positioning)
3. Government:
 - Financial supervisor (prudential intermediary behavior)
 - Treasury (tax income)
 - Other ministries (employment, environment, projects)
 - Certifying institutions (quality, employment)
 - Local authorities (employment)
4. NGO's (positioning, labor conditions, environment)
5. Consumer households (return, environment)



Governance: Problems

- Conflicts of interest. Esp. within government institutions (conflicting + hidden agendas). Mixing means with ends.
- Costs. Hidden and/or shifted.
- Trade-off mechanism. Not transparent as environmental goals are not made explicit and are not stated in operation terms.

RESULT: **suboptimal use** of the financial funds and the efforts, i.e. waste of resources.



Conclusion

1. Dutch Green Project Facility appears to be a success (many projects, much invested) but environmental goals are not defined.
2. Conflicts of interest because of unfocused public governance, hampers correct market ordering.
3. Opaque goals result in waste of financial resources and of human effort.
4. Results could improve when clear goals are set and when the key roles and the comparative advantages of the agents are acknowledged and respected.



Bert Scholtens
Professor of Finance
University of Groningen
PO Box 800
9700 AV Groningen
The Netherlands
++ 31 50 363 7064
L.J.R.Scholtens@ECO.RUG.NL

