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From the Editor: In this last issue of showCASE in 2018, our environmental economist Karolina Zubel reports on the discussions on climate change financing at the recent COP24.

The showCASE Editorial Team would like to take this opportunity to wish all our readers Happy Holidays and all the best in the New Year!

'Climate Money' and Fossil Fuels. Reflections After COP24

By: Karolina Zubel, CASE Economist

Concentrations of atmospheric greenhouse gases continue to rise at record rates, and climate damage is intensifying across the planet. In 2017, the CO_2 concentration in the atmosphere reached a record level and was 0.5% higher than a year earlier but by as much as 41% higher than in 1990 according to the latest report by the World Meteorological Agency (WMO). What is more, the Global Carbon Project estimates show that final fossil emissions this year will be higher again.

This issue, alongside many others related to the climate change, was discussed in depth between December 3rd and 15th in the Polish city of Katowice, where COP24, or the United Nation's (UN) Conference of Parties, took place. The 'Paris Agreement rulebook,' which was mandated in 2015 to be finalised by the end of COP24, has eventually been signed almost 30 hours later than initially planned. The package includes guidelines that will operationalise the climate transparency framework. The framework covers a multitude of issues such as how countries will measure, report on, and verify their emissions-cutting efforts or what rules should apply to voluntary market mechanisms such as carbon trading.

As all these much needed actions require sufficient amount of funding to be implemented, 'climate money' was one of the main themes of the political debate at the Katowice summit.

Climate change financing has for the first time played an important role – albeit for different reasons – at the infamous Copenhagen COP15 in 2009. When it became clear that no real agreement would be signed, an ambitious financing proposal was presented instead. 18 developed countries were supposed to help those most vulnerable and, starting from 2020, mobilise USD 100 billion a year to support the mitigation efforts of developing countries. Alas, the Green Climate Fund, which was supposed to be a key instrument for this, became operational only in 2014. Just before COP24, the UN confirmed that developed countries have managed to secure only 70% of the pledged funding thus far. At least another USD 30 billion have to be secured prior to COP25 in Chile.

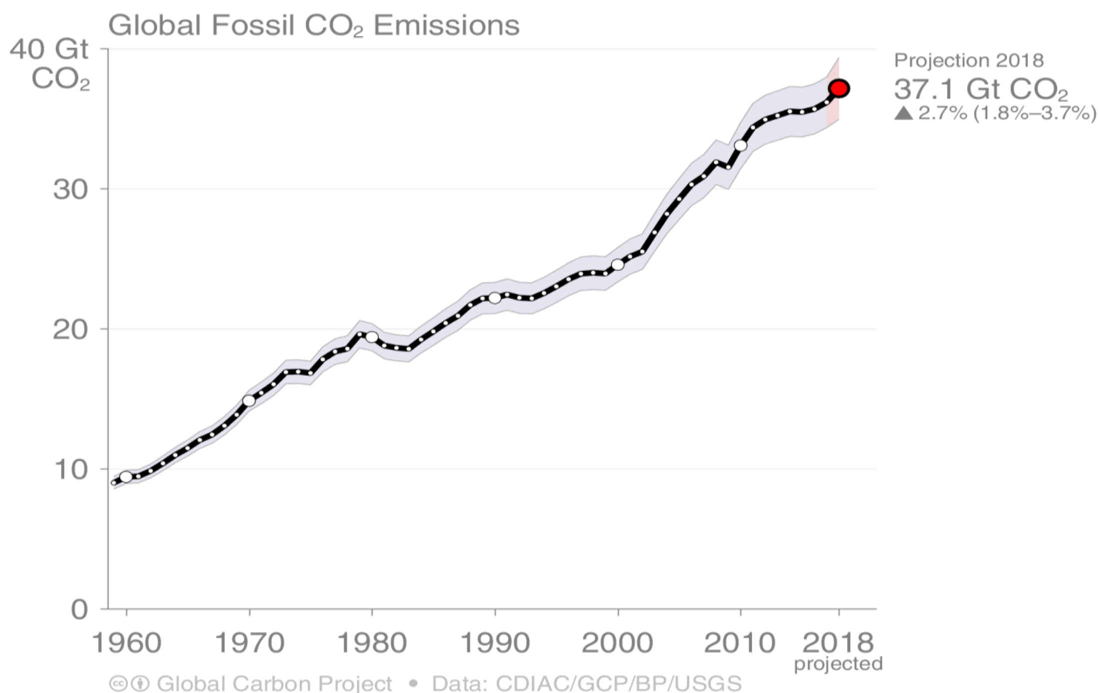
Such an amount is very unlikely to be collected from public sources only. Large private investors were therefore mobilised: representatives of pension and insurance funds, large banks, as well as asset management firms, attended the summit to advocate for green investments and full transition towards a low-carbon economy. Among them, multilateral development banks have been paving the way. In June 2017, the European Bank for Reconstruction and Development (EBRD) increased its target of annual climate-related investments from 25% up to 40% of its funding portfolio by 2020. The World Bank (WB), in turn, announced that 'in fiscal year 2018, 32.1% of its financing had climate

co-benefits – already exceeding the target set in 2015 that 28% of its lending volume would be climate-related by 2020'. Events and initiatives organised by the WB, such as the annual Innovate4Climate gathering banks, finance, and technology representatives to enhance their cooperation on climate finance, investments and climate markets, are also paving the way for further climate actions. During the last Innovate4Climate in Barcelona, for example, a call for proposals aimed at leveraging private investment was launched by the Green Climate Fund. With 350 submissions, the call proved extremely successful, with the 'Request for Proposal (RFP) financing oversubscribed 36 times, with bids totalling more than USD 43 billion.'

At COP24, green bonds, or bond earmarked to be used for climate-related and environmental projects, were discussed particularly fervently. According to the Standard & Poor's Financial Services LLC (S&P), the green bond market grew from USD 1.5 billion in 2014 to USD 27 billion in 2017. This pace of changes resulted not only from banks' policies but also from preferences of multinational companies like Apple. For example, in June 2017, following the United States Administration's withdrawal from the agreement reached at COP21 in Paris, Apple issued its second green bond of USD 1 billion – the largest bond issued by any American company until now.

Going green has become something to boast about. Banks present in Katowice were talking about their plans to procure electric cars to the banks' fleets and sharing experiences on becoming 'paper-less' or reducing the consumption of electricity (both for heating and cooling). Others, like the Polish branch of BNP Paribas, were proudly talking about their new headquarters that have BREEAM environmental certificates granted to buildings which can significantly contribute to the green transition.

Graph 1. Global fossil CO_2 emissions in the last decades



Source: Global Carbon Project. Data: CDIAC/GCP/BP/USGS

New energy technologies have to be accompanied by investments in energy efficiency. The same can be said about adaptation projects to climate change, such as investments in buildings resilient to difficult climatic conditions, which were heavily discussed for example in the COP24 Pacific and Koronivia Pavilion. In another project presented in the

ENERGIES2050 Pavilion, EuroPACE (implemented by a consortium coordinated by CASE thanks to funding from the European Union's Horizon 2020 programme), an innovative financial platform for home retrofits to improve existing buildings with energy efficiency equipment is being developed. The platform is fully financed through private capital and repaid in a form of on-tax financing scheme, which improves its sustainability.

Also during the summit, the '2018 Global Investor Statement to Governments on Climate Change' was signed by 415 investors, with USD 32 trillion in assets-under-management. In the statement, the investors called on governments around the world to foster action to tackle climate change and phase out fossil fuel subsidies. Beyond statements, private investors are already taking steps to address environmental challenges. Outflow of investments from the fossil fuel sector was indeed one of the most significant points discussed during COP24, when it has been confirmed that the number of public and private institutions, including a significant number of banks, vowed to divest from oil, gas and coal, surpassed 1000 in the 'Fossil Free' initiative led by 350.org. It is estimated that the total sum of money withdrawn from the fossil fuel-related industry since the campaign began in 2012 is now approaching USD 8 trillion.

COP24 confirmed that progress is being made to push climate finance forward. A shift in thinking and rapid action is still needed to close the gap between the actions which are already being taken and what is needed to mitigate the climate change and its effects. Financial institutions will play an increasingly important role in this transition, as confirmed by the investor's pledges discussed above. Such declarations give a beneficial context for implementation of initiatives based on private capital accessibility, such as the already mentioned EuroPACE project that CASE and its partners are developing across the continent. At the same time, in the following years, the list of institutions refusing to finance coal-fired power plants in Europe will likely significantly increase, and banks will be joined by insurance and reinsurance companies moving away from insuring mining or coal-based energy generation. Allianz, for instance, already plans to withdraw immediately from insuring single coal-fired power plants. Coal-oriented industry will have to look for financing outside Europe, e.g. in the USA, after the country decided to opt out from the ambitious Paris Agreement. Nevertheless, this can make the process of securing funds much more complicated and longer. The current plan of the Polish government to construct the Ostrołęka C Power Plant with a capacity of 1000 MW by 2023 worth roughly PLN 6.023 billion, instead of investing more in renewable sources like offshore windfarms, can thus be considered not only ecologically questionable but also financially challenging.

Trade, Innovation, Productivity

European Union's FDI Screening Framework Getting Closer to Coming to Life

After months of negotiations, on November 20th, the European Commission, the European Parliament and the European Council reached a provisional agreement on FDI (foreign direct investment) screening rules. The framework was designed to give the EU tools to protect its security and public order by virtue of scrutinizing third-country investments in strategic sectors. While some observers condemn the move as protectionist and imposing unnecessary burden on investors, the EC maintains it does not go against the EU's open market principles. Although the document does not mention China, addressing its expansion in the EU is believed to be the main motivation behind the move. Indeed, between 2008 and 2018, around 360 companies and a number of airports, seaports, and windfarms have been partly or entirely taken over by Chinese (mostly state-owned) companies. The framework still needs to be accepted by the EU Member States (some, like Greece, already oppose it).

European Union – Japan Trade Deal Ratified

The EU-Japan trade deal, "the biggest trade deal Europe has done (…) [and] the biggest trade agreement ever in the world" was ratified by the European Parliament following nearly five year of negotiations on December 12, 2018. The deal, which will enter into force as of 1 February 2019, is set to strengthen the already burgeoning trade relations between the two partners. Indeed, European firm are already exporting to Japan over EUR 86 billion in goods and services annually. Thanks to the agreement, they will save approx. EUR 1 billion in duties currently paid each year.

Labour Markets and Environment

Another Change to Pension Funds in Poland

President Andrzej Duda signed in the second half of November a new law introducing Employee Capital Plans (ECP, Pracownicze Plany Kapitałowe in Polish). ECP are a form of saving for retirement in which both employees and employers will contribute to employees' retirement savings. ECP are voluntary for employees but compulsory for employers: if an employee decides to save a part of salary (2-4%), then the employer must also contribute 1.5-4% of his or her salary. To encourage people to participate in the program, the state will additionally contribute PLN 250 for starters and later PLN 240 per year. ECP are one of the flagship projects of the current government which is trying to boost meagre domestic investments. Investment in Poland is on the record low level and rapidly decreasing (see Figure A). Investment rate in Poland is not only low in historical perspective but is also amongst the lowest in the entire EU (see Figure B). In the context of labour shortages, lowered retirement age, and unfavourable demographic perspectives, capital investments are of key importance for the future economic growth in Poland. It is, however, unclear whether the Polish society will trust the ECP after the infamous reform of the Open Pension Funds.

General computer and internet skills yield a substantial wage premium in Poland

Due to the rapid technological change and globalisation, computer and internet skills belong to the group of key competences currently in demand by employers. Those skills allow to quickly acquire information from various sources located worldwide, process it efficiently, and communicate with others. An econometric analysis based on data from three waves of the Human Capital Balance survey (BKL, 2012-2014) shows that the wage premium from general computer and internet skills amounts to 12-17% in case of individuals residing in Poland. This can justify incurring public and private expenditures on teaching these skills at schools.

Macroeconomics and Public Finance

New VAT Rules on Deductions for Passenger Car Expenses Without Negative Consequences for the Budget – Yet

As CASE roughly estimated, adapting the VAT rules on deductions for passenger car expenses to the PIT and CIT limits could have an annual budgetary impact of around 3 billion zlotys. From 1 January 2019 the new rules of deducting expenses in PIT and CIT related to the use of passenger cars in a company will enter into force. It is expected that when the cars are also used for private purposes 75 % of the expenses related to the use of such cars will be deductible for income tax purposes. It is therefore justified to ask whether the new limits in PIT and CIT should not be followed by a change in the limit applicable to VAT from 50% to 75%, which would be consistent with the regulations adopted in income taxes. However, before an appropriate legislative proposal is submitted by the government, it is necessary to issue a new derogation decision for Poland. This means that, from the beginning of 2019, instead of a simple, coherent system, two separate settlements of expenses related to the use of passenger cars in companies will be applied but for the time being without negative consequences for the budget.

Polish Economy Continues to Grow but the Outlook for the Future is not all Bright

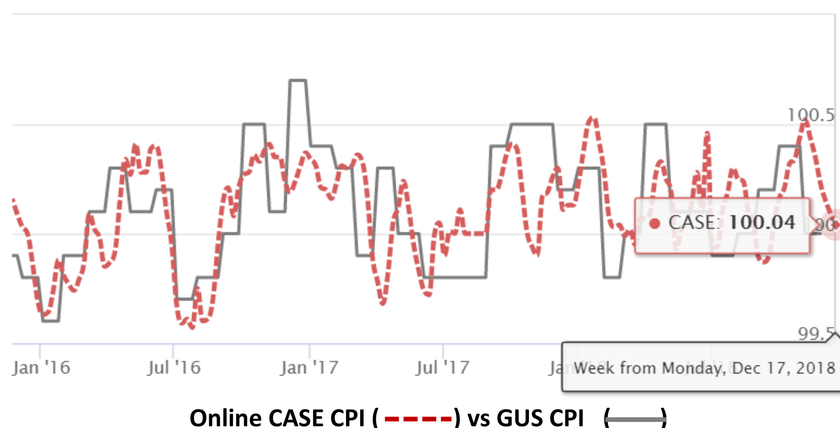
Data published on the last day of November by Statistics Poland (GUS) reveals that in Q3, Poland's GDP grew by 5.1%, investments increased by 9.9%, and private consumption by 4.5% (year on year, constant prices, seasonally unadjusted). Investments recorded the highest increase since 2015 Q1. While the number looks impressive on paper, the investments are still largely driven by the public sector – according to some private sector estimates, private firms' investments in the analogical period increased by 5-6% only. Such a structure of investments implies that private firms' prospects of productivity growth will be limited over the next periods. Meanwhile, private consumption still benefits from consumers' confidence and continues to be the main component of the GDP growth (at 2.7 pp., compared to 0.6 pp. of public consumption, 1.7 pp. of investments, 1 pp. of inventories, and -0.9 pp. of net exports). At the same time, following five quarters of growth at the level of approximately 5%, it now seems to be stabilising at a more sustainable level.

The Weekly Online CASE CPI

The online CASE CPI is an innovative measurement of price dynamics in the Polish economy, which is entirely based on online data. The index is constructed by averaging prices of commodities from the last four weeks and comparing them to average prices of the same commodities from four weeks prior. The index is updated weekly. For more information on our weekly online CASE CPI, please visit: http://case-research.eu/en/online-case-cpi.

Mid-December Online CASE CPI figures suggest that prices stabilised after a period of increases that lasted from September. Although the average prices of commodities are roughly the same as a month before, there have been important changes in some categories of the market basket. Most notably, prices in the transportation category fell by 2.2%. On the other hand, prices in the housing category went up by 0.6%, while the prices of food and beverages increased by almost 0.4% (as usual for this part of the year, the prices of fresh vegetables and fruits – with exception of citrus fruits – markedly increased).

Our Weekly Online CASE CPI



Online CASE CPI (----) vs GUS CPI (——)

Monthly CASE Forecasts for the Polish Economy

Every month, CASE experts estimate a range of variables for the Polish economy, including future growth, private consumption, and foreign trade, current account balance, and the CPI.

CASE economic forecasts for the Polish economy
(average % change on previous calendar year, unless otherwise indicated)

	GDP	Private consumption	Gross fixed investment	Industrial production	Consumer prices
2018	4,6	4.3	6,7	4.5	2.1
2019	3.5	3.6	3.3	3.8	2.3

	Nominal monthly wages	Merchandise exports (USD, bn)	Merchandise imports (USD, bn)	Merchandise trade balance (USD, bn)	CA balance (USD, bn)
2018	4.5	233.4	235.2	-1.8	-3.9
2019	3.7	242.7	244.6	-1.9	-4.1

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