Some thoughts on the Clean Energy Finance Corporation

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Contents

- What has been proposed
- Source of CEFC funds
- Application of CEFC funds
- Some thoughts on governance
- Some thoughts on operating principles
- Arguments for and against a green bank
- Some thoughts on critical success factors

What has been proposed ?

- The Government will invest $10 billion in the CEFC, with its mandate including:
  - commercialisation and deployment of renewable energy;
  - low emission technologies,
  - energy efficiency and enabling technologies, and
  - the transformation of existing manufacturing businesses to re-focus on making the inputs for these sectors.
- Independent from Government and run by a Board of experts in banking, investment management, clean energy and low emissions technologies.
- Once mature, CEFC is expected to be self sustaining.

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Source of funds

- Appropriations of the government's budget
- Green bonds ?
- Hypothecation of emission permit income ?
- Levies ?
- Re-allocation from other programs ?

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Application of funds

- R&D grants
- Equity
- Debt
- Ownership
- Securitisation of financial products (e.g. project finance)
- Credit guarantees
- Absorbing emission price or renewable certificate price risks
- Many others

Governance

- Government says : Independent from Government and run by a Board of experts in banking, investment management and clean energy and low emissions technologies. Employees members of Australian Public Service ?

- Many examples of government-owned corporations with Boards of Directors (appointed by government) that enjoy a reasonable level of political independence. But these typically deliver on-going services (e.g. electricity distribution) and recover their expenditure from their customers.

- But how realistic is it to expect a politically-independent CEFC that disburses public money on specific projects, rather than running a commercial undertaking ?

Some thoughts on objectives and operating principles

- What is the CEFC's main task: industry development, emission reduction, address market failures or developing renewables ? How are conflicting objectives to be resolved?
- Should the CEFC originate and develop its own projects, or should it just co-invest in projects developed by others ?
- Should the CEFC own and operate projects ? Should it build and then sell projects?
- Should it advise developers and governments ?
- Should it attempt to make markets in financial projects

Arguments for a green investment bank

1. By far the strongest argument: political and regulatory risk means investors and developers discount promises of income subsidies: a bird in the hand is worth two in the bush. Up-front subsidies can mean lower effective cost of capital - particularly valuable considering the capital intensive nature of renewables.
2. A balance sheet offers the prospect of financial leverage – increasing available funds.
3. Delivery: capital support can deliver results quickly.
4. Capital subsidies are more transparent than income subsidies (which are usually paid by energy users).
5. Flexible mechanism for capital support for technologies at different stages of development.

Arguments against a green investment bank

1. Picking winners: bigger problem when providing capital support rather than on-going income subsidies (because income subsidies can be stopped when the winner turns out to be a loser)

2. Crowding out the private sector (again, potentially bigger problem than with income subsidies)

3. Requires government to find the money up-front (rather than paid over the life of the plant).

4. Incentives for operating efficiency can be diminished if developers get their subsidy up-front.

9

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Some comments on success factors

- In a market economy, subsidising unprofitable technologies is always problematic.

- Up-front capital subsidies reduce political / regulatory risks with consequential reduction in the cost of capital (required rates of return). But:

  – Institutional risk aversion creates incentives for subsidy allocation to market-ready technologies (at expense of R&D for early stage technologies);
  – Problem of crowding out and moral hazard – need to be careful not to crowd out private sector, and to ensure effective risk allocation for development and operating risks.

- Desire for political independence will be hard to implement (and problematic when public money is being used).

- Plenty of examples of similar organisations (export finance corporations, development corporations, development banks). Important to learn from their successes and failures.

10

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