



Rabobank's view on incentives and proposals to green the economy

Introduction

What role can banks and government play in making the economy and society more sustainable? Which incentives work best? These are the questions that Rabobank reflects on in this position paper. After a brief description of Rabobank's role in sustainable finance initiatives, the paper discusses Rabobank's view on incentives and policy options to green the economy: binding restrictions on emissions, better functioning of the emission trade mechanism, use of tax incentives, reassessment of capital requirements in the light of climate risk.

Rabobank's role in sustainable finance initiatives

The Paris Agreement on climate change adopted on 12 December 2015 has generated many initiatives to substantially reduce CO2 emissions: governments, businesses, NGOs and citizens all over the world are working to achieve that goal. Rabobank is keen to contribute to these initiatives, as already stated with Dutch banks in a joint statement.¹

In co-making with clients/stakeholders Rabobank develops new solutions for the energy transition, isolation of houses and sufficient reduction of greenhouse gasses in the Food & Agri sector. Rabobank provides discounts to customers that invest in sustainability, e.g. in isolating their houses or in making their businesses more energy efficient. Further activities of Rabobank include the production of a study outlining the impact of flood risk in the Netherlands for the commercial real estate and mortgage portfolio of the bank, and participation to a United Nations Environment Programme - Finance Initiative (UNEP FI) pilot project on the implementation of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

At the policy level, Rabobank is closely following the debate in Brussels on the Sustainable Finance Action Plan launched by the European Commission in March 2018. Together with the Dutch Banking Association (NVB), European Association of Cooperative banks (EACB) and the European Banking Federation (EBF), Rabobank responds to it. Rabobank also takes part in sector sessions about climate change in The Hague ('Sectortafels'). The Dutch Minister of Economic Affairs and Climate Policy, Eric Wiebes, has charged the participants to put forward specific proposals to reach the goal of a 49% reduction in CO2 emissions by 2030, and an ambition on 55% reduction. The results of the 'Sectortafels' and new climate measures announced by the Dutch Cabinet are expected just before summer 2018.

How Rabobank promotes sustainable practices

In its [sustainability approach](#) Rabobank outlines how it shapes its dialogue about sustainability with customers, incentivizing front runners and engaging with laggards to

¹ We kindly refer to a joint statement of Rabobank and the other Dutch banks on the Paris Agreement: <https://www.rabobank.com/en/press/search/2017/20170628-sustainable-transition.html>

help improve their performance. Although the outcome of this engagement could ultimately be that not every customer stays with the bank, clearly the intent is to find ways that can build on support from both our clients and our other stakeholders. Of course, this process is multifaceted: for instance banks have no obligation to accept or maintain a relationship if their policies are not respected, and at the same time customers are free to choose the bank they do business with.

Rabobank's view on policy options to green the economy

Government policies

Rabobank considers it a priority that the government takes measures to green the economy. The government can place legally binding restrictions on emissions or on the use of energy sources, for instance. Such restrictions may include setting a minimum percentage of clean energy, or how many houses must have a certain energy label at a given point in time. An example of the latter is the requirement of the government that from 2023 and onwards all offices have to have a climate label that is better than C.²

Where possible, policies to green the economy should be coordinated at EU level in order to get the maximum effect and to safeguard a level playing field. In Rabobank's view these policies could also be supported to an extent by the use of targeted - and temporary/ evolving - subsidies, such as for green loans, for green deposits, investments in solar and wind-energy, and for innovation in more CO2 neutral food production.

Better functioning of the emission trade mechanism

To combat climate change, Rabobank believes that above all a better emission trade mechanism is needed. One that truly reflects the societal costs of emissions. In order to make the system work, the practice of giving free or cheap CO2 rights to certain industries should be abolished, for instance. Having in place an effective pricing mechanism for CO2 and for other greenhouse gasses helps to direct production and consumption towards more sustainable choices, without - if done well- the need for complicated coordination measures, elaborate controls, or the use of subsidies.

Use of taxes to change behavior

Further, Pigouvian taxes³ could be introduced, pricing externalities. Ideally, a Pigouvian tax will cost the producer the amount equivalent to the harm it causes others. Carbon taxes and gasoline taxes are Pigouvian. Provided they are designed well, these taxes create more efficiency in an economy and may help to fund investments towards a more sustainable economy. One of the questions to answer is whether the tax is set sufficiently high to be equivalent to the negative effect of the activity for others. Another is whether indeed the most important externalities are covered by the tax, and effects are not overlooked. There should not be too many exemptions. A drawback is that Pigouvian taxes impose a harsher burden on the poor than the rich because it is a flat tax. In

² See this [link](#) (Dutch) and an article [here](#).

³ A Pigouvian tax is a cost the government imposes on activities that create socially harmful externalities. An externality is an activity that creates a negative effect on others. According to Pigou, it is the task of the government to set equal the marginal private and social costs and benefits in order to promote overall welfare.



countries where the poor would suffer excessive impact from the tax, income support measures could be introduced for low income households.

Green or Brown capital factors: Recalibration of capital requirements

Rabobank would like to highlight the following points:

- Capital requirements must be risk-based, including climate risk-based, in order to safeguard stability. Recalibration of existing capital requirements will thus have to be based on analyses which activities/loans/ assets, as yet, do not account correctly for climate impacts.
- Clear and broadly supported definitions are needed about what is green and brown.⁴
- Data at the asset level will need to be gathered and analyzed. Businesses will have to provide such data according to their responsibility to map their own CO2 footprint.
- Approaches of recalibration must be granular. Some 'brown' companies may actually be making progress to decrease their CO2 footprint and to adjust in time for effects of climate change, and some 'green companies' may be very risky. Rabobank is not in favor of reducing capital for whole categories of green assets, if it is not based on lower underlying risks.

In this context, the European Commission has made the development of harmonized definitions (taxonomy) a priority in the European Commission's Action Plan on Sustainable Finance⁵. Rabobank believes this is helpful. However, it will be no easy task to give whole sectors a classification of 'green', 'brown', '(un)sustainable' or 'high risk', while individual companies in such sectors may in fact have very diverse profiles.

Conclusion

Greening the economy, changing customer behavior and how businesses operate, and a new perspective on how this is financed, are a challenge. Rabobank believes these changes can be attained and takes an active role. As illustrated with examples in this paper, Rabobank is involved in many sustainable finance initiatives at the national and global level. Rabobank's own sustainability approach is to have a dialogue with its customers, to stimulate front runners and to engage with laggards. Rabobank considers that the main government policy instruments to focus on are: place legally binding restrictions on emissions, improve the emission trade mechanism, use Pigouvian taxes and where necessary recalibrate capital requirements because of climate risks. All of this should be based on clear definitions, data, and it should allow for differentiation.

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⁴ Not only for capital factors but also for the use of Pigouvian taxes and for other policies.

⁵ See ([weblink](#)).