

July 6, 2020

*National governments, investors, and suppliers are putting pressure on companies from "dirty" industries to transition their strategies to low-carbon ones.*

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## The crisis won't hinder the decarbonization of the economy

### How trends in decarbonizing the world economy will affect Russia and its producers

Despite the coronavirus pandemic, major players in various industries continue to reduce the carbon footprint of their products. Funds for projects to modernize production facilities are often raised using "green" financing tools.

The plans of a number of governments to become carbon-neutral (adoption of the Green Deal in the EU<sup>1</sup> and South Korea<sup>2</sup>, and active discussion of the Green New Deal in the US<sup>3</sup>) are pushing companies to decarbonize their production.

Investors have also put pressure on so-called "dirty" industries, including coal. The examples of large companies like Glencore<sup>4</sup>, BHP Group<sup>5</sup>, and Rio Tinto<sup>6</sup>, have shown that this approach from investors is quite effective. Rio Tinto completely withdrew from the coal business in 2018. Glencore, under pressure from the investor group Climate Action 100+, was forced to review its strategy on coal assets. According to sources, BHP Group, the largest mining company in the world, decided to sell a large coal-mining asset in Australia.

Additional pressure on "dirty" production comes from suppliers and contractors. Google has pledged to stop developing software tools based on artificial intelligence for the exploration and production needs of oil companies<sup>7</sup>.

In this regard, businesses are forced to adapt their strategies to the new conditions. Many players, including steel giants, automakers, IT corporations, and even oil and gas companies, are already publicly declaring their plans to become carbon neutral by 2030–2050.

It is worth noting that companies themselves are actively involved in developing innovative ways to capture and transform CO<sub>2</sub> emissions. For example, the steel conglomerate ArcelorMittal has launched two large-scale projects, Steelanol<sup>8</sup> and Torero<sup>9</sup>, to introduce new breakthrough solutions as part of a commitment to reduce carbon emissions and develop low-carbon steel production technologies. German companies Thyssenkrupp and RWE<sup>10</sup> plan to jointly implement a new technology for producing iron using hydrogen by 2022. The German government, in turn, is ready to encourage new production and pay companies extra for emissions cuts at current EU prices.

<sup>1</sup> European Green Deal, the EU's development strategy and implementation plan, according to which the EU must become carbon neutral by 2050 ([https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal\\_en](https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en)).

<sup>2</sup> Green New Deal, South Korea's development strategy, according to which the country must become carbon neutral by 2050 and stop funding the construction of coal-fired power plants (<https://www.climatechangenews.com/2020/04/16/south-korea-implement-green-new-deal-ruling-party-election-win/>).

<sup>3</sup> Green New Deal, package of laws proposed in the US that aims to address climate change and economic inequality (<https://www.nytimes.com/2019/02/21/climate/green-new-deal-questions-answers.html>).

<sup>4</sup> <http://www.profinance.ru/news/2019/02/20/br3k-glencore-ogranichivaet-dobychu-uglya-primknuv-k-storonnikam-energeticheskogo-sdv.html>.

<sup>5</sup> <https://www.mining.com/bhp-to-sell-australian-thermal-coal-mine/>.

<sup>6</sup> <https://de.reuters.com/article/us-rio-tinto-plc-coal-divestiture/rio-tinto-exits-coal-with-2-25-billion-kestrel-sale-idUSKBN1H31WI>.

<sup>7</sup> <https://www.forbes.ru/tehnologii/401013-pochemu-google-otkazalsya-delitsya-iskusstvennym-intellektom-s-neftyanikami>.

<sup>8</sup> Steelanol, an industrial demonstration plant that will collect waste gases from steel plants and turn them into bioethanol recycled from carbon (<http://www.steelanol.eu/en>).

<sup>9</sup> Torero, a large-scale demonstration plant for processing wood waste into bio-coal (<http://www.torero.eu/>).

<sup>10</sup> RWE plans to build electrolyzers that will be powered by solar and wind generation and have a capacity of 100 MW. The electrolyzers will be able to produce about 1.7 tons of hydrogen per hour, which will then be used by Thyssenkrupp on its mini-blast furnace for the production of iron (50,000 tons per year) (<https://www.metalinfo.ru/ru/news/117100>).

Other industries are keeping up with metal producers. For example, diamond producers are experimenting with capturing carbon dioxide with the tails of recycled kimberlite<sup>11</sup>, and Lufthansa has begun developing eco-friendly fuel<sup>12</sup>.

In addition to indirect business risks associated with pressure from investors, governments, and suppliers, the failure to decarbonize production and take into account climate factors can carry direct financial risks, e.g., the cost of adapting business models to changing climate conditions, disaster recovery, and environmental penalties.

**In Russia**, few are moving in the direction of decarbonization, despite the risks listed above. These include Arkhangelsk Pulp & Paper Mill, the leader in terms of reducing greenhouse gas emissions<sup>13</sup>, and RUSAL, one of the largest aluminum producers in the world, which has launched ALLOW, its own low carbon aluminum brand<sup>14</sup>. However, in general, at Russian companies the climate agenda is far from becoming a priority.

In the future, delaying the decarbonization of production facilities may also result in a collapse in the export earnings of Russian companies<sup>15</sup>. The lack of systemic measures for accounting and reducing greenhouse gas emissions will soon be considered by foreign regulators as environmental dumping, and therefore Russian exporters will have to pay duties to ship their products to developed markets at the same rates and volumes as those set by local regulators.

In ACRA's opinion, this scenario can be avoided if Russian companies become more open and use modern financial instruments, namely "green" bonds. These instruments not only provide access to more affordable financing, but also ensure high quality and transparent reporting, which would allow Russian issuers to stand their ground against foreign regulators.

ACRA notes that the government is increasingly paying attention to environmental issues. The implementation of the National Project "Ecology" involves RUB 4.04 tln of expenditures, of which only 20% will be funded by the budget. It appears that the remaining 80% will be sourced at the expense of businesses. Furthermore, environmental law is being made more stringent. ACRA assumes that due to the massive oil spill in 2020, the size of fines, which didn't even reach RUB 1 bln in 2019, may increase.

ACRA sees very large potential for production modernization projects in Russia. At the present time, when attention is so highly focused on ecological improvements, these projects should be included in long-term corporate strategy. ACRA is of the opinion that not only toughening requirements and strategic plans can stimulate companies to carry out such projects, but also subsidies for environmental projects provided by the Ministry of Industry and Trade.

It is also noteworthy that the taxonomy of "green" projects is not static<sup>16</sup> — the list of projects that European regulators classify as "green" is gradually shortening. For example, last year Chinese companies managed to receive "green" certification for environmental projects involving coal power plants. Now, according to the EU

<sup>11</sup> <https://www.rough-polished.com/ru/expertise/117274.html>.

<sup>12</sup> <https://plus-one.ru/news/2020/05/20/lufthansa-nachinaet-razrabotku-ekologichnogo-aviatopliva>.

<sup>13</sup> In recent years, the company has cut its greenhouse gas emissions by 41% compared to 1990. (<https://www.appm.ru/upload/iblock/5fc/5fc187c13ed5ff7efd5ac184b0347e92.pdf>).

<sup>14</sup> <https://www.metalinfo.ru/en/news/98261>.

<sup>15</sup> <https://www.eceee.org/all-news/news/eus-anti-climate-dumping-tool-worries-russia/>.

<sup>16</sup> <https://regnum.ru/news/polit/2901050.html>.

Recovery plan released in May this year on reviving its economy after the COVID-19 crisis, even gas projects cannot be classified as "green". They will instead be regarded as "transition" projects and may only be carried out to replace coal power plants<sup>17</sup>. In light of this, the window of opportunity for modernizing the Russian economy and increasing its environmental friendliness via "green" bonds is not that big. The state, represented by VEB.RF, is ready to support the development of the "green" part of the economy by raising around RUB 300 bln<sup>18</sup> to help Russian companies.

ACRA assumes that crisis phenomena in the global economy will only serve to accelerate the trend of its decarbonization. In order to minimize existing risks, including those related to the permafrost thawing, Russia must follow this trend.

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<sup>17</sup> <https://www.euractiv.com/section/energy-environment/interview/pascal-canfin-on-gas-and-nuclear-eu-must-apply-green-finance-taxonomy/>.

<sup>18</sup> <https://www.rbc.ru/economics/15/06/2020/5ee6a6ac9a79473a66792e5c>.

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