Political Risks and Climate Change: Where Are the Flashpoints?

Climate Policies Raise Scope for Political Risk to Manifest on Several Fronts – A Joint Report from Sustainable Fitch and Fitch Solutions

> "Political risk, including polarisation over climate issues and concerns over a just transition, can cause climate policy instability or stalling. This political landscape could be arduous to navigate for investors, which are increasingly tasked with allocating capital to low-carbon technologies with long lifespans and payback periods."
>
> Source: Sustainable Fitch

Climate change and political risks will mutually reinforce each other as both transition risk, which results from the global shift toward a low-carbon economy, and physical risks rise. Capping temperature rises at well below 2.0° Celsius above pre-industrial levels – aiming for under 1.5°C – as resolved under the Paris Agreement, implies significant societal and economic changes.

The Forecast Policy Scenario, developed by Inevitable Policy Response, sees an accelerated and forceful policy response from the mid-2020s and maps the most likely policies to be implemented. These include cuts to agricultural and land-use emissions, including ending deforestation by 2030 and the sale of combustion-engine vehicles in China, Germany, France, Italy and South Korea by 2035.

The Inevitable Policy Response estimates that these and other policies will limit global warming to around 1.8°C, but much tougher policies are required to achieve a safer ceiling of 1.5°C.

This analysis – co-authored with the Political Risk team at Fitch Solutions, a Fitch Group company, and using its proprietary political-risk indices to gauge short- and long-term country-level risks – explores the political issues that may arise from the low-carbon transition and the implications for the pace of climate policy adoption. This commentary does not reflect Fitch Ratings' views.

The state of political risk can dictate progress on domestic climate-related policy, which can then directly influence the geopolitics of climate policy. Political polarisation can cause climate policy instability or stalling; the US, Australia and France provide recent examples. Concerns around a 'just transition' and fairly sharing the burden of effort can also delay progress towards decarbonisation.

Meanwhile, poorly designed climate policies raise the scope for domestic unrest, as higher prices and economic dislocation weaken the government's capacity to soften the impact on lower-income groups. This can also lead to regulatory volatility and heighten the probability of a disorderly global transition, with businesses and communities having to adjust to delays and disruptive policy shifts.

This political landscape could be arduous to navigate for investors, who are increasingly tasked with allocating capital to low-carbon technologies with long lifespans and payback periods.

Meanwhile, physical risks, such as rising sea levels and tensions around water, food and energy, are likely to result in population migration and could also be a major destabilising factor for countries with an already-high political risk score and low climate adaptation capability.

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Analysts

Marina Petroleka
marina.petroleka@sustainablefitch.com

Matt Sechovsky
matt.sechovsky@fitchsolutions.com

Aurelia Britsch
aurelia.britsch@sustainablefitch.com

Political Trends Risk Stalling Climate Policies

The 2021 UN Climate Change Conference, commonly referred to as COP26, highlighted the global divisions around the pace and pathways towards decarbonisation. The key areas of contention included the role of coal-fired power generation and ambitions for climate-change mitigation and adaptation, as reflected in the updated Nationally Determined Contributions (NDCs), which embody each country's efforts in meeting Paris Agreement goals.

Warming projections depend on the level of climate action. The policies currently in place around the world are projected to result in about 2.7°C warming above pre-industrial levels, according to a Climate Action Tracker's analysis from November 2021, while the full implementation of 2030 NDCs would see a 2.1°C rise. The best-case scenario, which assumes the implementation of all announced targets, including net-zero targets and NDCs, would limit the temperature rise to 1.8°C.

This means keeping temperatures rises within 2.0°C will require a steady pace of stringent policies and regulatory intervention, in addition to technological innovation and behavioural change. However, there is a persistent regulatory gap, where the slow pace of action on climate mitigation in the near-term risks more disruptive and disorderly intervention in the long term.

This gap may deepen if political risks deter policy makers from implementing decarbonisation policies. In emerging markets (EMs), this could be compounded by mitigation and adaptation funding gaps. Pledges by developed markets (DMs) to financially and technologically assist EMs could counteract this risk, but have so far fallen short of targets.

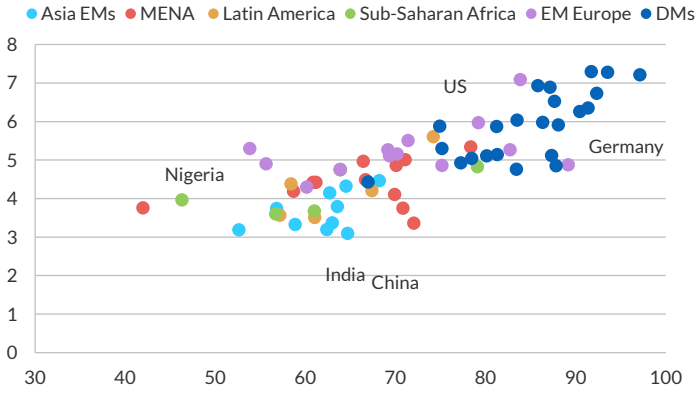
Most governments have set net-zero carbon emission goals by mid-century, though China has set a target date for carbon neutrality by 2060 and India a symbolic target of 2070; neither goal is aligned with scientific consensus, but balances economic development needs with a desire for leverage in negotiations with DMs over climate finance and targets.

Progress in matching climate policy with decarbonisation goals varies. DMs generally have greater funding capacity, economic resilience and political stability then EMs, placing them in a better position to implement decarbonisation policies and adapt to climate change. This capacity affects and is affected by political stability: most DMs score highly on Fitch Solutions' Long-Term Political Risk Index and HSBC's Climate Vulnerability Index (see following chart). Among DMs, the US scores towards the bottom, while Germany ranks in the middle. Meanwhile, India, Pakistan and south-east Asian countries are among the most vulnerable EMs due to their high sensitivity to extreme events and low ability to respond.

Decarbonisation policies are also likely to be better accepted in DMs, due to the potential impact on EMs' industrialisation and economic growth.

DMs and European EMs Most Resilient:

Selected countries

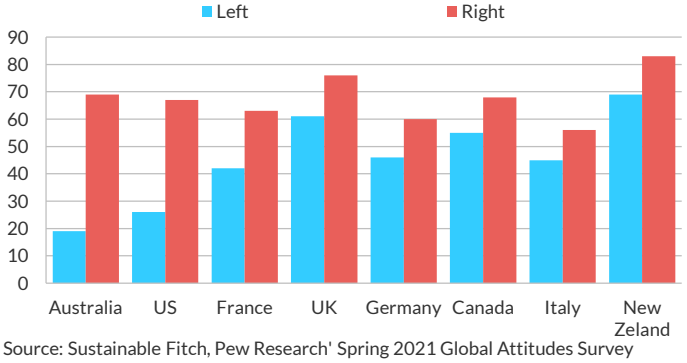


Horizontal axis: shows Fitch Solutions' Long- Term Political Risk Index – scores out of 100, with 100 being best
Vertical axis: shows HSBC Climate Vulnerability Index – scores out of 10, with 10 being best
MENA: Middle East and North Africa
Source: Fitch Solutions, HSBC.

That said, some DMs are also experiencing substantial domestic divisions on the strictness of climate policies that should be implemented to decarbonise their economies, which could herald discontent and protests as well as climate policy discontinuity or even gridlock. Among DMs, we expect Australia and the US, followed by France and the UK, to be particularly vulnerable to this trend, as attitudes to climate change mitigation in these countries are strongly distributed along ideological lines.

US & Australia Most Polarised on Climate Change

Percentage of population by ideological leaning that believes its country is doing a good job tackling climate change



Source: Sustainable Fitch, Pew Research' Spring 2021 Global Attitudes Survey

Liberal democracies may face heightened policy uncertainty over the long timeframes required to tackle climate change, due to regular changes of government. The perception of a breakdown of political consensus on key social and environmental issues in many major democracies in recent decades could also challenge climate policy continuity.

Investors could find this political landscape difficult to navigate, particularly as they endeavour to allocate capital to low-carbon technologies that have long lifespans and payback periods in accordance with investment mandates. Examples of such technologies span new lithium extraction techniques and sites to new mines of 'future-facing' minerals such as copper, to scale the hydrogen economy.

The US has already experienced major U-turns on climate change policies, as reflected in Washington's departure from and subsequent re-entry into the Paris Agreement. The decision taken by the US Supreme Court in June 2022 to limit the Environmental Protection Agency's authority on setting emission standards for power plants is one of a rising number of examples of policy divisions. The Court stated that only Congress has the power to create a broad system of cap-and-trade regulations to limit emissions in a bid to transition away from coal to renewable energy. The decision also signifies rising resistance by conservative groups against stricter climate policies and what they perceive as some authorities exceeding their core mandates (see box on the right).

In Australia, the Labor Party's May 2022 election victory is likely to herald loftier decarbonisation measures, after years of lagging government climate policy. This will be spurred by the strong showing of environmentally focused minor parties and independents demanding more ambitious climate policies than Labor's manifesto commitments. The country has since submitted a revised NDC to the UN's Intergovernmental Panel on Climate Change, with a target 43% reduction on 2005 emission levels by 2030; this is a 15% increase on the previous NDC.

European countries have proved more resilient to policy fluctuations, but are not immune to them. France's efforts to accelerate decarbonisation via fuel taxes led to violent protests in 2018 by the yellow vests, while in the UK, the strong consensus on a low-carbon transition could be tested by rising energy costs in the absence of market reform. Divisions on the pace and approach to reaching carbon neutrality are also deep between the partners in Germany's coalition government, with the Greens advocating for much steeper intervention in Germany's economy than what the Social Democratic Party of Germany, particularly the fiscally conservative Free Democratic Party, is likely to accept.

The EU Commission's ambitious Fit-for-55 energy transition package, introduced in July 2021, has met fierce opposition from parts of the EU parliament and faces a narrow path to adoption. Moreover, tensions have emerged regarding the EU's taxonomy of sustainable activities – with France and Germany pushing to include nuclear and gas activities owing to their existing energy and industrial structure. This has brought the European Council and European Commission increasingly into conflict with the European Parliament, parliamentary members and civil society.

Immediate Policy Priorities Compete with Long-Term Climate Action

The ongoing global energy crisis, food shortages and war in Ukraine have altered policy priorities for many countries. Energy shortages have elevated the short-term importance of energy security, with governments temporarily tolerating higher emissions over the next year or two. Some DMs are also reconsidering their near-term decarbonisation targets; for example, Germany is preparing to revive coal power plants to curb reliance on Russian hydrocarbons.

DM backtracking on some policy commitments could diminish the climate efforts of developed countries amid perceptions of unfair burden shifting. This EM-DM divergence could be exacerbated by Russia's invasion of Ukraine, as most EM governments outside the EU are willing to maintain economic relations with Russia, and have often capitalised on discounted imports of Russian oil, such as India.

Climate Policy Volatility in the US

Climate policy in the US has been subject to abrupt changes in recent years, reflecting political and state divisions on climate action. At the federal level, this has been exemplified by shifting climate goals: in 2015, the Obama administration submitted moderate emission reduction pledges under the Paris Agreement, designed to avoid the need for approval from a divided congress. Similarly, a number of sectoral climate policies were delivered through presidential executive orders or direction to executive agencies. This occurred in parallel with ambitious state-level initiatives in New York, Illinois and California, among others.

The Trump administration subsequently made sweeping changes to key executive agencies and loosened sectoral policies, including the Corporate Average Fuel Economy standards for vehicles and methane emission reduction targets for the energy sector. The administration also symbolically withdrew the US from the Paris Agreement, citing aspects of the treaty that it felt ran counter to domestic economic interests.

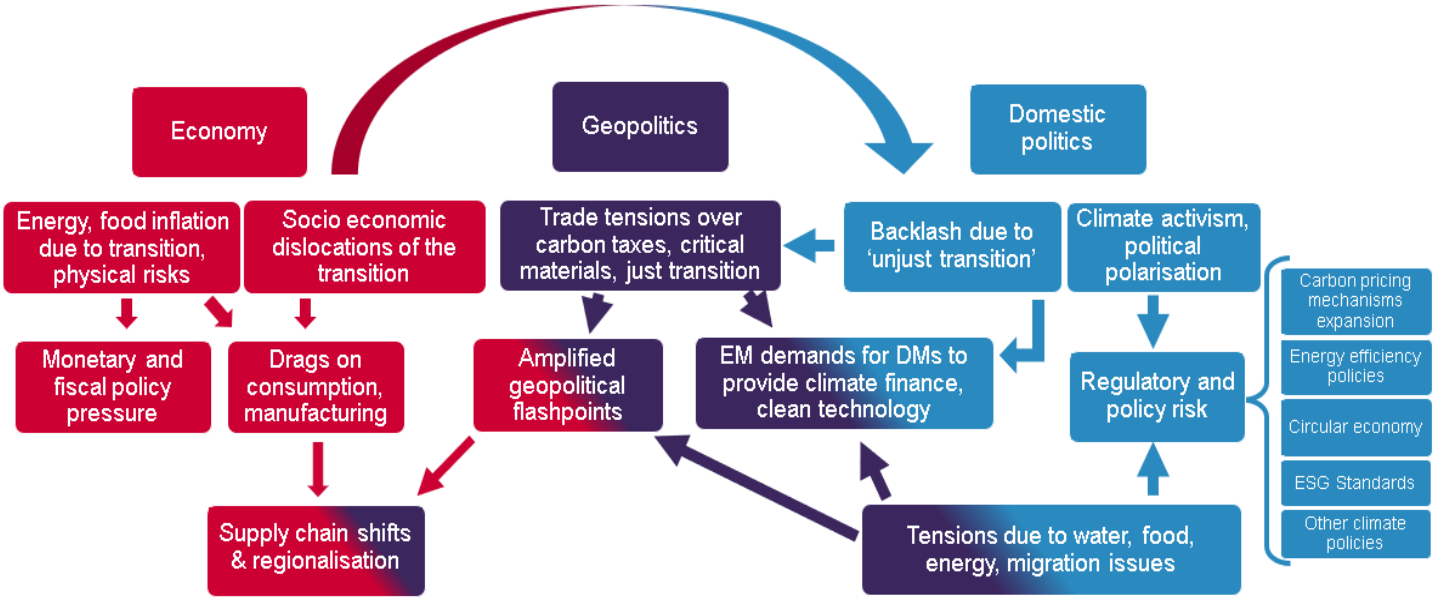
These changes were again reversed by the Biden administration in 2021. The bulk of changes were made through executive orders rather than congressional policy, calling into question the long-term policy stability of these goals. While a bipartisan infrastructure bill passed in 2021 contained funds to support low-carbon transition of grids, electric-vehicle charging infrastructure and hydrogen energy development, most of the provisions to meet the country's climate commitments were contained in the Build Back Better bill, which was withdrawn in 2021 in the face of senate opposition.

Heightened political polarisation between US states is also reflected in climate policy, with increasingly aggressive climate targets from Democratic-leaning states and their large public pension funds. Many of these institutional investors have implemented environmental, social and governance investment screening strategies, including divesting of fossil fuel activities.

However, several Republican-leaning legislatures, particularly those with large extractive industries, have turned the divestment trend on its head, passing state legislation requiring public asset owners to cease business with asset managers that have fossil fuel divestment policies. The Texas Comptroller's office was the first to implement this policy, with similar bills now introduced in West Virginia, Louisiana and Oklahoma. This has led major asset owners to demonstrate their continued commitment to fossil fuel financing to these clients, while emphasising their commitment to a low-carbon transition to satisfy the demands of other clients in the US and elsewhere.

In practice, the Texan legislation is likely to face many hurdles to implementation, but it highlights the widening climate regulatory asymmetry at the state level, which will assumedly manifest as rising policy instability at the federal level, with standards for energy and industrial sectors shifting with changes in government.

Potential Flashpoints Between Geopolitical and Domestic Political Risks and Climate Change



Source: Sustainable Fitch, Fitch Solutions

The energy-supply crunch is likely to ease in the coming years, but is a stark reminder that climate policy is regularly challenged and can be side-tracked at times of crisis. There already exists a plethora of geopolitical risks that could derail climate policy efforts, including structural China-US tensions and deglobalisation trends. These can move immediate policy priorities and state budgets away from climate policy and disrupt low-carbon technology supply chains.

Socioeconomic Dislocation Can Undermine Progress on Climate Agendas

'Unjust Transition' in Focus

The issue of a just transition, which refers to mitigating the negative socioeconomic consequences of switching to a low-carbon economy, is gaining prominence. These consequences, which are becoming more visible, include unemployment and the potential cessation of essential services following the loss of tax or export revenue. Coal and agriculture are at the forefront of the issue, though it can manifest across a range of economic sectors.

These issues can add to concerns that ambitious decarbonisation policies will trigger a backlash as net-zero pledges are implemented. Governments may choose to channel public spending to affected sectors to mitigate these problems.

To this effect, the EU has approved a dedicated Just Transition Fund, totalling EUR17.5 billion, to be allocated over 2021-2027. EU governments can also tap other EU funds, such as the NextGenerationEU fund and the Common Agricultural Policy, as well as national resources to address socioeconomic dislocation. The bloc is also negotiating the Fit-for-55 policy package, which could finance up to EUR59 billion over 2027-2032 to shield low-income citizens from the policy's costs.

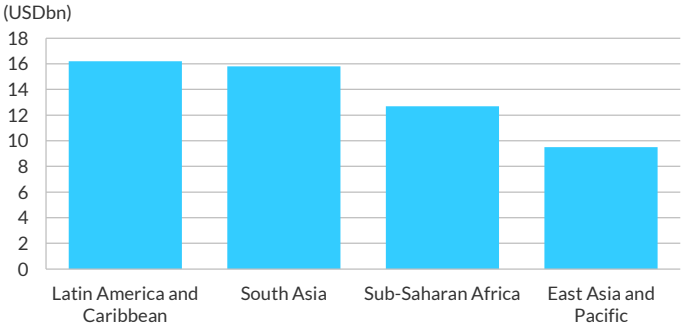
Individual countries are also setting up their own compensation funds, including in Germany, where the coal phase-out plan includes arrangements for operators and economic support packages in coal regions worth about EUR40 billion. Globally, this appears to be adding to government subsidies and other protectionist measures in politically sensitive sectors, such as agriculture.

EMs Will Struggle to Adapt

While DMs may have greater funding capacity to support a Just Transition, EMs – which will be particularly affected by the direct and indirect impact of climate change – could be unable to provide grants to affected areas and communities, given their fiscal constraints and less favourable access to international capital markets. EMs are likely to become reliant on concessional lending and blended finance arrangements to finance a just transition. The failure of higher-income states so far to mobilise the pledged USD100 billion a year to help emerging economies with transition financing has exacerbated the issue.

Adaptation Finance Gap by Region

Public and private spending vs. average estimated annual needs



Source: Fitch Ratings, World Bank, Commonwealth Scientific and Industrial Research Organisation, Vivid Economics

The lack of progress made at the Bonn Climate Change Conference in June 2022 – meant to further negotiations and set the stage for COP27 – reveals the tensions between developed and developing countries around funding as well as 'loss and damage' compensation for the consequences of rising temperatures in the coming decades.

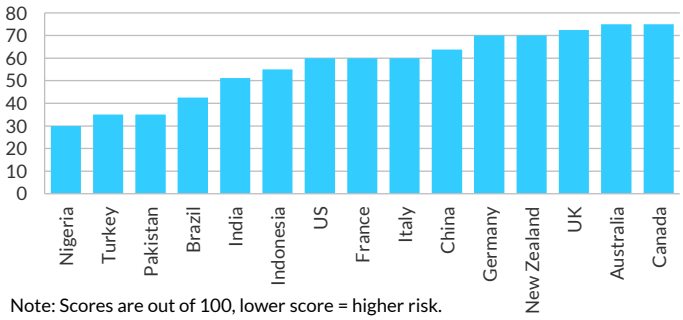
DMs appear to be making progress mobilising funding to help EMs transition, as shown by the negotiations of the Just Energy Transition Partnership; an USD8.5 billion funding deal agreed in principle at COP26 by several developed nations and South Africa. However, a disappointing final agreement, failure to expand the framework to other coal-dependent EMs or further delays to mobilising the large promised sums would add to the unwillingness of EMs to commit to reducing emissions and to a costly phase-out of coal fired power generation.

China and India have already intervened to amend language in the COP26 final communique on efforts to phase out coal, and we expect such unwillingness to be pronounced in socially unstable countries, where frequent protests will discourage governments from pursuing economically painful decarbonisation policies.

Countries that could be more vulnerable to this risk include Nigeria, Turkey and Pakistan, which have low social stability scores under Fitch Solutions' Long-Term Political Risk Index. The physical and transition impacts of climate change could further exacerbate these risks and lead to conflict, with lower crop production, falling commodity exports and a deterioration in the balance of payments weakening governments' fiscal positions and shrinking the resources needed to address social disparities.

Protests To Impede Rapid Decarbonisation

Select Countries - Fitch Solutions Social Stability Scores



Note: Scores are out of 100, lower score = higher risk.
Source: Fitch Solutions

Climate Migration to Drive Political Risk

We expect internal displacement and migration to rise as EMs struggle to adapt to the effects of climate change. This will stir ethnic tension and political polarisation, particularly where such migration coincides with existing friction or poverty.

The Internal Displacement Monitoring Centre has found that the largest portion of displacement due to natural disasters and climate change occurs in relatively politically stable countries, such as China, India and the Philippines. However, as the physical impacts of climate change rise, migration and displacement in less stable regions, such as sub-Saharan Africa (SSA), is likely to increase. Within SSA, Kenya, Nigeria and South Africa could be particularly vulnerable, given the region's high exposure to extreme weather events, water insecurity and temperature change.

We expect displacement to foster anti-immigration sentiment and harsher asylum policies globally, particularly between regions that have large gaps in economic development. This includes the US and Latin America, Europe and its neighbourhood and southern Africa. This theme was a major issue in electoral campaigns throughout the 2010s, often paralysing legislatures that were unable to formulate policy or enabling protectionist leaders to win office.

Stranded Assets, Coal Decommissioning Require Funding

We expect the risk of asset stranding to mount, with changes in demand, regulations and policies, as well as physical damage and losses, affecting the fossil fuel, agriculture and real estate sectors.

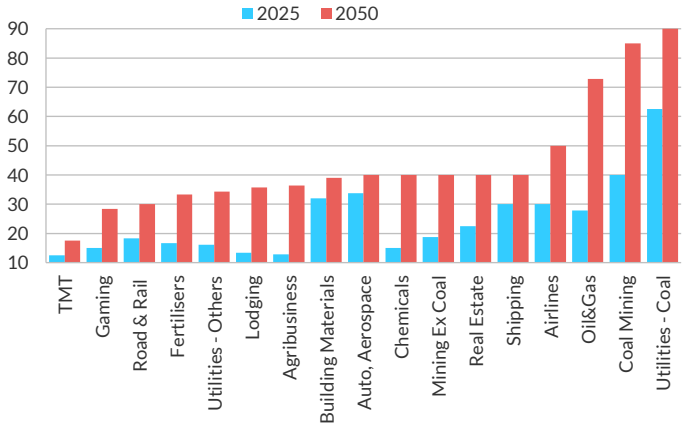
Main Sources of Stranding Risk in Different Sectors:

- Fossil fuels: Loss of demand, higher carbon prices, stricter emission controls and reporting requirements, faster-than-expected uptake of renewable energy.
- Agriculture: Extreme weather, droughts, floods, higher cost producers of green-house gas intensive sectors, such as beef.
- Real estate: Rising sea levels, high insurance costs, unavailability of insurance in high physical-risk areas, permanent emigration, stricter energy efficiency policies making some older and lower-value buildings too costly to retrofit.

Coal power and oil and gas assets face the greatest risk, though risks will vary by project. Projects with poor cost-competitiveness and high carbon intensity, such as Canada's heavy oil deposits, are at greater risk. However, we expect tighter environmental regulation to push operators to cut their carbon intensity and avoid asset stranding, placing them in a strong position in the long-term. In contrast, operators that fail to make such investments may benefit from higher short-term profitability, but this will be eroded as market access and demand eventually declines.

Varying Risks of Stranded Assets

Fitch Ratings' Climate Vulnerability Scores for Corporates



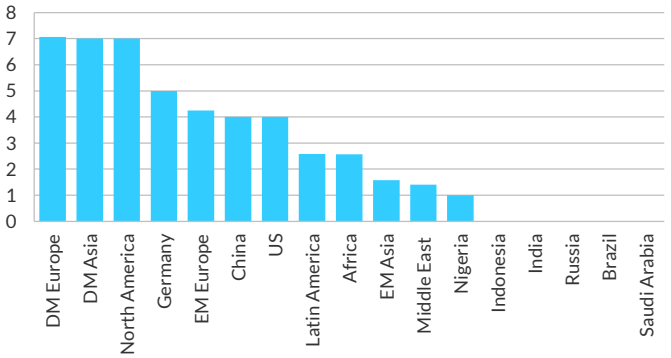
Note: Scores based on a scale of 10 to 90; higher scores denotes higher vulnerability.
Source: Sustainable Fitch, Fitch Ratings

Asset stranding risk could be heightened for carbon-intensive economies with high fossil-fuel production costs and limited or non-existent carbon pricing schemes, as changing regulations abroad slash external demand for their products. A sharp tightening of domestic climate policies could lead to a similar outcome. That said, this would require a sudden and unexpected reduction in demand for fossil fuels or carbon-intensive goods, which is unlikely given that governments would look to avoid major economic disruption.

Sensitivity to carbon pricing is also influenced by the price elasticity of demand for goods and services; for example, oil demand has historically proven to be inelastic to price increases, with higher carbon prices likely to be passed on to customers. Conversely, regions that move quickly on carbon pricing could see competitive pressure from oil production and substitution with low-cost overseas production.

Higher Stranded Asset Risk at EMs that Lift Carbon Prices

Selected Areas – Carbon Pricing Score, 2022



Note: Scores are out of 10, higher score = more comprehensive pricing scheme
Source: Fitch Solutions

The issue of stranded assets as a result of the transition to a low-carbon economy is often considered in terms of financial risk to shareholders and investors, but it can have major macroeconomic implications that accentuate political risks. This is especially so for economies or regions that depend on fossil fuel as a source of government revenue, which is commonly used to fund public-sector employment and subsidies and mitigates the risk of public unrest.

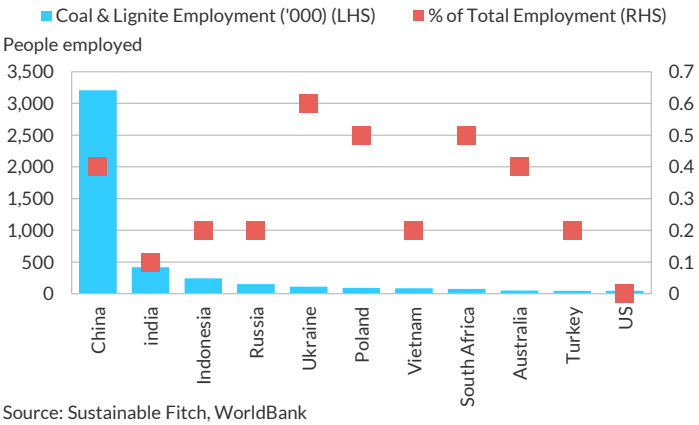
Moreover, many coal-utility assets in EMs are held by state-owned entities, suggesting that state-linked companies could bear the brunt of decommissioning costs and liabilities where coal is being phased out. A recent World Bank study found decommissioning costs can range from an average of USD58,000/megawatt (MW) in India to USD117,000/MW in the US. This implies that multi-billion US-dollar liabilities will fall due in coming years.

The accelerated retirement of fossil fuel, particularly coal-power plants, will also frontload costs and liabilities. Whether effective funding solutions, such as South Africa's Just Energy Transition Partnership, can be developed to manage these decommissioning liabilities will be critical for the success governments' coal phase-out plans and the prospects of achieving a 'just transition'.

Opportunity costs associated with foregone revenue present a further challenge for the financial profiles of utilities where governments seek to retire coal-plants early – that is, before the end of their normal operating life – as part of ambitious climate policies. A badly managed decommissioning of coal and fossil fuel assets could trigger public discontent. For instance, pollution from abandoned oil infrastructure is a major source of political unrest in the Niger delta in West Africa.

Just Transition Implies Mitigating Coal Job Losses

Coal Employment In Largest Coal-Producing Countries



Source: Sustainable Fitch, WorldBank

DMs' Decarbonisation Policies Could Stall EM Growth

The climate policies of DMs, such as the phase out of coal in power generation and electric vehicle proliferation, will curtail long-term demand for oil and coal imports and weigh on the export revenue of commodity-exporting countries. This reflects the global discrepancy between DMs, which are primarily consumer-focused economies, and EMs, which are mostly export-oriented resource-dependent economies. A significant share of DM emission cuts have been attained through the effective 'offshoring' of emission impacts from resource extraction and manufacturing to EMs. Sweden is the first country to set a consumption-based emission target, but the majority of countries set emission-reduction targets on a territorial basis, shifting the burden of emissions cuts to exporting countries.

DM's other decarbonisation policies could hinder growth prospects for sectors beyond oil and coal. For example, the EU Carbon Border Adjustment Mechanism, which aims to introduce a carbon price on certain imported products to avoid 'carbon leakages', could decrease exports of a wide range of products out of EMs, limiting opportunities for export-led development. Not all exporting countries are at risk, but some are likely to lose out, first among them are higher-cost suppliers.

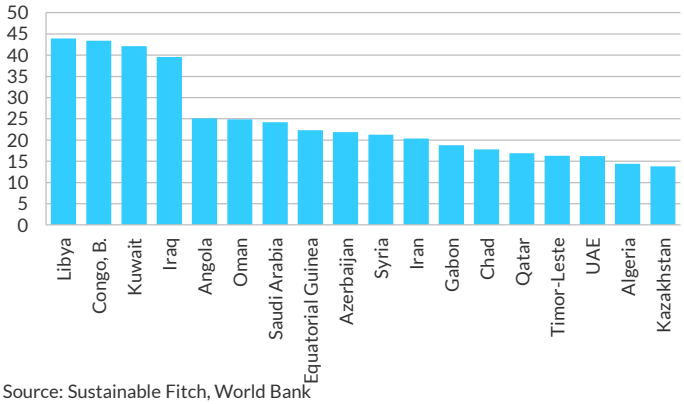
Lower government revenue and a weakened outlook for some EM sectors will weigh on employment and could create social discontent. EM governments affected by carbon taxes are likely to push back and potentially retaliate, adding to geopolitical friction: Turkey and Algeria will be among the most affected by the EU's Carbon Border Adjustment Mechanism, putting them at higher risk trade tension and immigration cooperation.

Most oil-dependent economies have begun aggressive diversification drives to avoid major economic disruption. This includes Saudi Arabia's Vision 2030 programme, launched in 2016. However, the extent and pace at which such initiatives can deliver may be limited for some EMs due to a low political will to open the economy to the private sector. That said, Fitch Solutions does not forecast demand for oil to peak before 2032 based on current

trends, while demand for natural gas is likely continue rising until the 2040s. This means the risk of hydrocarbon asset stranding is not likely to become widespread until the 2030s at the earliest.

Dependence on Fossil Fuel for Income of Select Countries

Oil Rents
(% of GDP)



Source: Sustainable Fitch, World Bank

Price Volatility, Greenflation Fuel Discontent

Climate change (physical risks) and the implementation of decarbonisation policies and ensuing socioeconomic changes (transition risks) are likely to add to long-term commodity price volatility and could increase inflation, dubbed 'greenflation'. This could, in turn, fuel discontent and thwart climate policies.

Agriculture is a major greenhouse gas contributor, but also one of the most vulnerable sectors to weather pattern disruptions. Prices of agricultural commodities are likely to record periods of tight supply and higher prices, as more frequent extreme weather events, such as droughts, fires, floods and a structural rise in temperatures, lead to crop failures and challenge yield growth. In a 2021 analysis, Fitch Solutions found that of the world's seven largest agricultural producers – US, China, Brazil, the EU, Russia, Canada and India – most will see yields for key crops come under pressure, and only a minority of countries or crops will see improved agricultural conditions. For example, higher average temperatures are projected to weigh on rice production in south and southeast Asia.

Food price inflation can be acutely destabilising for lower-income countries and markets that suffer from underlying political issues, such as sectarian conflict and entrenched anti-government sentiment. For instance, food inflation contributed to the Arab Spring uprisings, which were preceded by severe droughts in the late 2000s that weighed on food supply and stronger demand for food imports from Asian markets. The vulnerability of the global economy to similar shocks is elevated in 2022 and 2023, as Russia's invasion of Ukraine has disrupted food supplies.

In terms of transition risk, policies that seek to limit greenhouse gas emissions from agriculture can also have an inflationary effect either at source, through carbon taxes, or at the point of consumption if import levies are applied to capture emissions.

Energy prices are also likely to remain volatile over the next few years. Uneven gas supply was the prime factor behind rising electricity prices across Europe in 4Q21 and 1H22, though the rise of intermittent renewables has added pressure to electricity prices. Fitch Solutions believes the greater use of short-term power storage systems in Europe will soften the impact of variable power on grids and reduce intraday reliance on gas, producing greater price stability over the medium term.

However, near-term discontent with soaring electricity and fuel prices will remain a source of political risk. This risk is well-known in DMs, particularly since France's yellow vest protests in 2018, and can be mitigated by government spending. Most European governments have been implementing a range of fiscal measures to shield consumers from rising electricity and fuel bills over the past year or so. However, governments in poorer European EMs are struggling to cushion electorates, leading to phased blackouts in Kosovo and popular protests.

The current energy crisis and Russia's invasion of Ukraine highlight the vulnerability of different regions and economies to shifts in energy systems. The move to a lower carbon economy will require deep changes in the energy mix away from coal and, in due course, natural gas, though political pressure will weigh on implementation. The polarising debate in Europe over the European Commission's proposal to include natural gas and nuclear power in the EU Green Taxonomy highlights the underlying tension between an ambitious decarbonisation agenda and the potential costs and technological constraints of re-aligning existing energy infrastructure.

Carbon taxation and the pricing of the externalities of pollution is another major area of discussion, particularly around how to extend carbon pricing schemes from their current focus on high-polluting industries to the rest of the economy. As carbon pricing schemes expand over the coming years, inflationary pressure across supply chains is likely to rise, from fast fashion to electronics, cheap manufactured goods and low-cost air travel.

Climate Activism and Domestic Unrest

We believe climate policies will increasingly become the subject of protests, driven by climate activist groups calling for even stricter policy action. Such groups gained significant momentum prior to the Covid-19 pandemic, especially in Europe, and largely resumed their campaigns in 2021. These campaigns have raised awareness and popular support for climate policies, but their demands are likely to be watered down by green political parties to make them more palatable to the wider electorate, as was most recently the case ahead of the German federal election in September 2021.

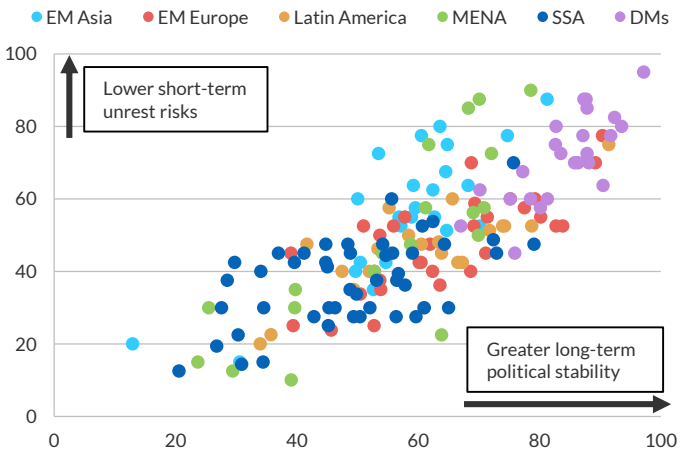
We expect this trend to sustain further climate campaigning, as activists continue to demand greater action, but we do not believe that there will be a major acceleration of climate policies at the expense of social stability.

The success of climate activism is difficult to measure, but campaigns have influenced climate policies in the past. For example, the fossil fuel divestment movement of the past decade evolved from student activism to sway the investment policies of major asset owners.

Such grievances, alongside the risk of wider unrest and state capacity to mitigate the consequences of climate change, are reflected in Fitch Solutions' Long-Term Political Risk Index score, which is particularly low in sub-Saharan Africa, North Africa and some Eastern European countries, implying higher risk. In contrast, DMs, Gulf states, and Central and Eastern Europe tend to perform better, implying lower risk of a major, policy-changing backlash against climate policies.

Climate-Related Protests to Amplify Wider Political Risks

Global – Fitch Solutions Social Stability Score (y axis) Long Term Political Risk Index (x axis)



Note: Scores are out of 100, lower score = higher risk
SSA stands for sub-Saharan Africa'
Source: Fitch Solutions

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