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Decarbonising the world economy: what needs to happen after the UN Climate Change Conference

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Bonn, 23 November 2015. In just a few days' time, the world will be looking to the UN Climate Change Conference, where an ambitious agreement is set to be concluded with a view to protecting the world from a dangerous temperature increase and to preparing for and responding to the effects of climate change. As the conference approaches, warnings are mounting that the planned contributions of member states to reducing greenhouse gas emissions will be insufficient to keep the temperature rise below 2°C. As a result, calls are being made for these countries to raise their ambitions and also provide sufficient climate finance for developing countries. While this is all well and good, it is nowhere near enough. If we are to bring about decarbonisation, that is, cease to use fossil fuel energy sources in future, then we need to reform global economic governance. Action is required in three key areas in order to achieve this.

Pricing for decarbonisation

Setting higher prices for goods and services with a large carbon footprint provides a greater incentive to reduce emissions. This is why we need a global carbon price. Revenues from carbon taxes and emissions trading schemes could even be used to finance other development goals and efforts to reform energy use and taxation systems. There is also an opportunity to kill two birds with one stone when it comes to reducing fossil fuel subsidies. It is possible to put an end to price distortions detrimental to decarbonisation (thereby removing this obstacle to climate change mitigation and green technology) and ease pressure on national budgets at the same time. Savings from subsidy reductions could be used to implement these politically fraught measures, for example, by compensating the poor for their income shortfall and others who have lost out. Issuing payments for ecosystem services is another potential way to limit climate change. It involves compensating landowners and farmers for maintaining carbon sinks such as forests and soils.

Trade and investment rules

Rules for international trade and investment should also take account of climate change. Despite having made little progress in recent years, the World Trade Organization (WTO) remains a forum in which global regulations are designed and implemented. Concluding the Doha Round would allow more green issues to be added to the agenda going forward. A number of pioneers, including the EU and 13 other states, are already blazing a trail in this regard with their efforts to negotiate an Environmental Goods Agreement on the dismantling of barriers to trading in these goods. The aim is to roll out the benefits of the agreement to all WTO members. These environmental goods will be used to improve air and water quality, facilitate waste management and promote the generation of renewable energy. There is also a trend towards strengthening the environmental provisions in trade and investment agreements. Many of the new agreements prohibit their signatories from lowering environmental standards and entitle them to continue introducing regulations that benefit the environment. The Transatlantic Trade and Investment Partnership (TTIP) in particular has an opportunity to leverage its sheer size and public presence to lead the way in the integration of trade, environmental and climate goals.

Shaping financial markets

Financial markets are the third key area of action. If long-term, low-carbon investments are to be encouraged, it is necessary to reform the international financial system in such a way that commercial banks and institutional investors such as sovereign wealth funds, pension funds and insurance companies invest to a greater degree in low-carbon projects. Current regulations leave little to no scope for doing so; regulatory authorities need to do more to change this situation. Financial market actors can also play their part in encouraging decarbonisation by adopting voluntary green guidelines for their investment decisions. In the absence of a global carbon price, an ambitious notional shadow price can serve as a decision-making aid to companies considering their investment options. The consistent inclusion of climate risks in ratings, benchmarking models and indices could help investors to develop a sustainable investment strategy. Public donors and development financing institutions such as development banks should also make risk-mitigation instruments available to motivate investors to invest in green assets. A lack of information means that the risks associated with these investment opportunities are often perceived as being far higher than they actually are.

Setting our sights high with regard to the Paris agreement is only the first step. But this will not be enough, as it will take many more actors to step up to the plate if we are to reform global economic governance. We need to keep moving forward after Paris. Other institutions such as the G20, central banks and the WTO must take up the baton and pave the way for developing a new green mindset in their respective spheres of influence.