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Climate action or profit? Both!

Private investment as an opportunity

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Bonn, 4 June 2018. Policy-makers and representatives of the financial industry and technology firms came together for the Innovate4Climate fair in Frankfurt in late May. Over three days, they discussed ways that private firms and investors could contribute to the achievement of climate policy objectives and generate a profit at the same time. Topics ranged from investment in renewable energies to carbon markets and innovative climate-risk insurance schemes. The event underlined the trend of the private sector playing an increasingly active role in climate change mitigation and sustainable development in recent years, areas traditionally considered to be the responsibility of policy-makers. What should we make of this?

One thing is clear: In order to achieve the objectives of the 2015 Paris Agreement and set the global economy on a climate-friendly development path, a tremendous amount of investment is needed around the world. The industrialised nations have committed to providing USD 100 billion per year to support climate change mitigation efforts of developing countries. However, there is a need for far more investment in climate action and sustainable development overall: The OECD estimates that the global infrastructure investment need between 2015 and 2030 in areas such as energy supply and transport will swallow up some USD 100 trillion in total. The task of mobilising the necessary capital and ensuring that it is invested in innovative and climate-friendly technologies cannot be handled by policy-makers alone, which is why it is essential to bring private investors on board.

What drives the private sector

It is important in this context to understand the motives behind climate-friendly investment. While ethical concerns will certainly be the motivation for a growing proportion of investors who incorporate climate change mitigation measures into their activities, it is undeniable that many investors are simply on the lookout for new business models and income opportunities. This is driven not least by the challenging economic environment in which old business and investment areas are crumbling in the face of developments such as the current low interest rates, shifts in economic power towards Asia, and mega trends such as digitalisation.

While we may fear that key climate change mitigation and sustainable development objectives could be subordinated to private revenue interests, we should view this as a major opportunity. If policy-makers manage to provide the right incentives and framework conditions for investors, then an increasingly large proportion of private capital will be invested in accordance with the goals of climate change mitigation and sustainable development.

Balancing voluntary action and regulation

Setting the right rules in this area is very important. They must ensure that climate-friendly investments are climate-friendly in more than just name. The market for green bonds illustrates very well the opportunities and challenges for private investment. Green bonds are still a relatively new financial instrument used by companies to collect money from private investors with the pledge of investing it in green projects. However, there is some debate over which projects can truly be described as green. While this may still be the case for solar energy, it is no longer clear when it comes to the installation of upgraded filters for coal-fired power stations for example. And it is not always certain whether the funds collected for green projects are actually additional or whether it is simply a case of putting a green label on investments that have would have happened anyway.

Voluntary action can prove key to creating transparent rules here. At the initiative of representatives of the financial industry and other stakeholder groups including non-governmental organisations, voluntary rules such as the Green Bond Principles and the Climate Bond Strategies have already been created and are being refined on an ongoing basis. This can help to provide more information and transparency for investors and the general public.

Policy-makers are well advised to build on such voluntary private-sector initiatives and develop them further. This will make it possible to strike a balance between the interests of policy-makers and those of the business sector. On the one hand, the rules become more widely accepted and are tailored to the needs of the private sector, and, on the other hand, it is possible to ensure that these rules are effective and take into account the interests of all societal groups. As such, the European Commission will shortly present its own set of rules for classifying green financial products, which also take account of voluntary standards. International platforms such as the G20 should also be used to harmonise rules and standards at international level. This would ensure that the private sector makes an effective contribution to meeting the global need for investment and achieving climate objectives.

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