Financing Climate Safety

NEW YORK – The purpose of the global financial system is to allocate the world’s savings to their most productive uses. When the system works properly, these savings are channeled into investments that raise living standards; when it malfunctions, as in recent years, savings are channeled into real-estate bubbles and environmentally harmful projects, including those that exacerbate human-induced climate change.

The year 2015 will be a turning point in the effort to create a global financial system that contributes to climate safety rather than climate ruin. In July, the world’s governments will meet in Addis Ababa to hammer out a new framework for global finance.

The meeting’s goal will be to facilitate a financial system that supports sustainable development, meaning economic growth that is socially inclusive and environmentally sound. Five months later, in Paris, the world’s governments will sign a new global agreement to control human-induced climate change and channel funds toward climate-safe energy, building on the progress achieved earlier this month in
negotiations in Lima, Peru. There, too, finance willloom large.

The basics are clear. Climate safety requires that all countries shift their energy systems away from coal, oil, and gas, toward wind, solar, geothermal, and other low-carbon sources. We should also test the feasibility of large-scale carbon capture and sequestration (CCS), which might enable the safe, long-term use of at least some fossil fuels. Instead, the global financial system has continued to pump hundreds of billions of dollars per year into exploring and developing new fossil-fuel reserves, while directing very little toward CCS.

Many investments in new fossil-fuel reserves will lose money – lots of it – owing to the recent fall in world oil prices. And many of the fossil-fuel reserves that companies are currently developing will eventually be “stranded” (left in the ground) as part of new global climate policies. The simple fact is that the world has far more fossil-fuel resources than can be safely burned, given the realities of human-induced climate change.

Though market signals are not yet very clear, this year’s more successful investors were those who sold their fossil-fuel holdings, thereby avoiding the oil-price crash. Perhaps they were just lucky this year, but their divestment decision makes long-term sense, because it correctly anticipates the future policy shift away from fossil fuels and toward low-carbon energy.

Several major pension funds and foundations in the United States and Europe have recently made the move. They have wisely heeded the words of the former CEO of oil giant BP, Lord Browne, who recently noted that climate change poses an “existential threat” to the oil industry.

More governments around the world are now introducing carbon pricing to reflect the high social costs inherent in the continued use of fossil fuels. Every ton of carbon dioxide that is emitted into the atmosphere by burning coal, oil, or gas adds to long-term global warming, and therefore to the long-term costs that society will incur through droughts, floods, heat waves, extreme storms, and rising sea levels. While these
future costs cannot be predicted with precision, recent estimates put the current social cost of each added ton of atmospheric CO₂ at $10-100, with the US government using a middle-range estimate of **about $40 per ton** to guide energy regulation.

Some countries, like Norway and Sweden, long ago introduced a tax on CO₂ emissions to reflect a social cost of $100 per ton, or even higher. Many private companies, including major oil firms, have also recently introduced an internal accounting cost of carbon emissions to guide their decisions regarding fossil-fuel investments. Doing so enables companies to anticipate the financial consequences of future government regulations and taxation.

As more countries and companies introduce carbon pricing, the internal accounting cost of carbon emissions will rise, investments in fossil fuels will become less attractive, and investments in low-carbon energy systems will become more appealing. The market signals of CO₂ taxation (or the cost of CO₂ emission permits) will help investors and money managers steer clear of new fossil-fuel investments. Carbon taxes also offer governments a crucial source of revenue for future investment in low-carbon energy.

With international oil prices dropping – by a whopping $40 per barrel since the summer – this is an ideal moment for governments to introduce carbon pricing. Rather than let the consumer price of oil fall by that amount, governments should put a carbon tax in place.

Consumers would still come out ahead. Because each barrel of oil emits roughly 0.3 tons of CO₂, a carbon tax of, say, $40 per ton of CO₂ implies an oil tax of just $12 per barrel. And, because oil prices have declined by more than triple the tax, consumers would continue to pay much less than they did just a few months ago.

Moreover, new revenues from carbon taxes would be a boon for governments. High-income countries have promised to help low-income countries invest in climate safety, both in terms of low-carbon energy and resilience against climate shocks. Specifically, they have promised $100 billion in climate-related financing per year, starting in 2020, up from around $25-30 billion this year. New revenues from a CO₂ tax would provide an ideal way to honor that pledge.

The math is simple. High-income countries emitted around 18 billion tons of CO₂ this year – roughly half of all global emissions. If these countries earmarked just $2 per ton
of CO₂ for global financing organizations like the new Green Climate Fund and the regional development banks, they would transfer around $36 billion per year. By using part of that money to mobilize private-sector financing, the full $100 billion of climate financing could be reached.

Both Big Oil and Big Finance have made major mistakes in recent years, channeling funds into socially destructive investments. In 2015, these two powerful industries, and the world as a whole, can start to put things right. We have within our reach the makings of a new global financial system that directs savings where they are urgently needed: sustainable development and climate safety, for ourselves and for future generations.
PS Polls

Do you expect the Eurozone crisis to continue in 2015?

- Yes, it was never solved
- Yes, if policies don’t change
- No, but southern Europe needs help
- No, the eurozone has achieved stability

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