Financial system change, not climate change

In recent years, some of the most successful campaigns on climate change have focussed on divestment from fossil fuels, the burning of which is predominantly responsible for causing climate change. Putting pressure on banks, pension funds and university endowments can stop – or significantly delay – big fossil fuel projects. This pressure can deliver victories that are important for the momentum and morale of campaigns to save the planet. It also keeps the focus on fossil fuel companies, chipping away at their “social license to operate” in a world of accelerating climate change.

Divestment campaigns are, of course, just one tactic. And when campaigners win, the larger financial system chugs ahead, often as though nothing has changed. After engaging in divestment campaigns, many of us are asking: what else can we do to augment the power of this tactic?

The following suggestions are drawn from Financial System Change, Not Climate Change, a forthcoming report from the Institute for Policy Studies and the Transnational Institute. The report focusses on the intersections between the financial system and climate change, looking at how banks and investors can be weaned off their addiction to fossil fuels. It surveys a wide range of possibilities, from modest reforms to wide ranging structural changes, that can help to reshape the finance system in response to climate change.

**Banks** account for the largest share of investment in both fossil fuels and renewable energy. Recent global efforts have focussed on making climate-related investment more transparent, which is welcome but far from adequate.

The mandate of **central banks** should include an explicit focus on social and environmental objectives, as well as financial system stability. They should use this mandate to take a more interventionist stance, promoting green banking guidelines that prioritize loans for renewable energy, efficiency and other climate-relate actions.

New measures could including putting a “credit ceiling” on investments in fossil fuels; holding lenders liable for the climate and broader environmental consequences of their investments; and revising international banking rules (“capital requirements”) that currently make renewable energy investments less attractive.

If we are to avoid a repeat of the 2008 financial crisis, the **“too big to fail” banks should be broken up.** This is the only way to weaken the lobby power of financial institutions that have lobbied hard to avoid reforms to the banking sector, including measures to prioritise social and environmental goals.

Further efforts should be made to encourage the growth and re-emergence of **local savings banks and cooperatives.** Such institutions have shown themselves to be particularly effective in supporting climate-friendly measures, in particular those which have a not-for-profit public interest mandate. Examples from Germany show how these banks can offer financial products that target savings towards local renewable energy and efficiency investments, as well as the potential for such institutions to cooperate with public development banks to ensure that their lending is locally accountable.

**State-owned banks** and non-banking financial institutions could also play a key role in financing a transition. However, strong accountability mechanisms need to be in place to avoid the mistakes of existing national development banks that have supported fossil fuel projects, and often ignored the needs and wishes of local communities.
Major changes are needed to the rules governing financial markets and the way large corporations are run. New rules for investors (including pension funds) should give environmental and social concerns a more central role in investment decisions. This should be reflected in how large companies are structured, too, with new corporate charters emphasising a broader environmental and social responsibility, rather than simply the pursuit of profit. The composition of company Boards could be changed to involve workers’ representatives, or enhance employee ownership.

Putting limits on executive pay is another obvious place to start. The massive bonuses awarded to top executives encourage short-termism. Bonuses should be explicitly linked to sustainability goals, with ratios limiting the pay of top executives relative to employees. Requiring sustainability clauses and pay ratios to be written into public procurement contracts can be a good first step.

Public sector institutions play a significant role in creating and shaping markets. They set the rules and regulations without which markets could not function, create a range of incentives (and penalties) for investors, and are often the leading investors in new and expanding markets that the private sector is too timid to enter. For example, new investment rules for state pensions and Sovereign Wealth Funds could make them green leaders, although that would often require changes in organisational culture.

Tackling climate change requires significant increases in public investment – both domestically, and through international climate finance. The best chance of achieving this is to increase the tax base by closing tax loopholes. Big companies routinely use offshoring and transfer pricing - the everyday tools of corporate globalisation – to avoid taxes. A system of “unitary taxation” could be developed to ensure that taxes are more readily paid in the jurisdictions where companies have genuine operations, rather than mere shell companies. The recommendations of the OECD’s Base Erosion and Profit Shifting project should be implemented in full. Tax avoidance by super-wealthy individuals could also be tackled, by shifting from a system that taxes their income to one that taxes their “net worth.” Increasing the tax base for public investment should be seen as part of a broader rebalancing that would ultimately shrink the role of the financial sector as a whole.

Simply increasing public investment is not enough, without at the same time improving the accountability of companies and institutions to the public, workers and affected communities. Public ownership of the energy sector, transport companies and infrastructure providers should be considered a key part of reclaiming public control. Instead of the old model of centralized state companies, or public companies managed in the style of private corporations, new models of public management and accountability should be pursued. From Hamburg to Hawaii, a growing number of “remunicipalized” public utilities are showing how this can be done.

Ten years on from the financial crisis, the biggest banks have grown larger, and some of the financial regulations intended to prevent a new crisis have already been rolled back. Yet there is no sign that the financial system is any better at allocating resources to invest in a just transition to a cleaner economy. While the urgency of tackling climate change means that improvements need to be made within the current system, these need to happen at the same time as challenging the role that “big finance” plays. A financial system that works for the climate will be one in which the role played by the financial sector is considerably smaller.

Financial System Change, Not Climate Change will be published by the Institute for Policy Studies (www.ips-dc.org) and Transnational Institute (www.tni.org) in October 2018.