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Dragging Finance Out of the Fossil Age

An interview with Molly Scott Cato
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In November 2019, the European Investment Bank announced that it was stopping fossil fuel investment. Elsewhere, ratings agencies warned of the risks oil majors were carrying by not adjusting to a low-carbon future. The growing push against fossil fuel investments comes on the back of pressure from activists and politicians, as well as doubts over their future worth. But divestment will not happen by itself, regulation is needed too. Last month, we sat down with Molly Scott Cato, Green MEP and economist, to discuss the EU's sustainable finance package, alternatives to the current banking model, and the role speculation played in Brexit.

Green European Journal: What is the European Commission's sustainable finance package?

Molly Scott Cato: The sustainable finance package is about making sure that customers know what their money is doing and creating incentives to move money into sustainable activities away from unsustainable activities. It makes a series of proposals based on the advice of an expert group made up of financial sector and sustainability experts. An important part of the package tries to avoid the greenwashing of finance by tightly defining what a green financial product is.

Which parts are the most important to reduce future carbon emissions?

The disclosures regulation and the benchmarks regulation – both en route to becoming law – are key. Disclosure means that in future financial players and people who sell financial products, including bank loans, will have to be open and clear about the sustainability impact, in climate terms and more broadly, of the products they offer. For about half the financial products currently on offer, you do not know where your money is going. You might be green-minded, but not realise that your pension is invested in fossil fuels and firms cutting down the Amazon to plant soya. Forcing companies to be transparent and disclose this information is going to transform how such financial products are sold. Financial players do have a get-out clause whereby they refuse to disclose anything, but if that is the case you can draw your own conclusions.

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The benchmarks regulation is about establishing indexes for large-scale investors. Many investors are passive investors, which means they just allow their money to follow an index of companies created and maintained by a financial market player. The regulation creates benchmark indexes dedicated to sustainable companies to increase the amount of money going towards their activities.

The Paris-aligned benchmark will label the greenest activities out there. If you are a university pension fund and you have decided to only invest in sustainable firms, this index will make sure that your money is only channelled in renewable energy companies, electric car producers, and the like. The climate transition benchmark is about incentivising the transition. Funds invested in this benchmark can go to companies that might be high-energy companies but which are moving rapidly towards greater sustainability. Companies will have to prove that they are on the right path to be included. A cement company that might today be producing large amounts of emissions but that is working to align with the Paris agreement will be better able to attract investment through this index.

How is sustainability defined?

There is a third regulation on taxonomy about defining sustainability for sustainable investment. It is still being negotiated but hopefully will be completed by the end of the year. There has been a lot of argument over whether nuclear or airport investment should be excluded from products marketed as sustainable. I find these considerations incredible, but the right-wing parties argue that even sustainable product should be allowed a certain amount of fossil fuels. This is the agenda's weakness and some countries are looking to block progress and water down.

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Is it fair to say sustainable finance is more about encouraging greener forms of investment rather than stopping more money going into fossil fuels?

The sustainable finance agenda is about clearly signalling that we are going to remove fossil fuels from our economy. As a British Green, I want that to happen by 2030. The European Union has sort of, nearly reached the point of saying 2050, even though some of the Visegrád countries such as Poland are holding it back. If that is the case, then fossil fuels should not be in the portfolio of any pension funds because come 2050, that investment will be worthless. Direct measures such as the energy package will eliminate fossil fuels, but signalling to the markets that they should move their money elsewhere is crucial too.

How has the financial sector reacted to these proposals?

The insurance and pensions industries have been leading on this agenda. The pensions industry has to take a long-term perspective and the insurance industry is already bearing the costs of climate change and other aspects of the environmental crisis as well. An insurance firm insuring a farm cares about nitrogen cycles and soil erosion because that is what the farm's value is based on. Insurers have to focus on the actual material value of what they are insuring, and so sustainability is key.

Some of the investment houses are not so positive but only the fossil fuel companies have pushed back. The financial players mostly think about what they can profit from. If we can successfully signal that fossil fuels will lose their value, they'll follow to maintain their profits.

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A recent *Guardian* report that showed that just 20 companies are responsible for about one third of modern era emissions. How should we deal with the fossil fuel giants, when ultimately we want their whole business

model to be destroyed?

The fossil fuel giants have lied for years. They knew. Exxon knew in the 1970s that what they produced was going to destroy the climate and still lied about it. For 40 years, they have been encouraging the production of oil and blocking the development of electric cars. As Extinction Rebellion says, they should have told the truth [read more about XR's demands]. The climate emergency is on the fossil fuel companies, as are the deaths that will be caused by climate change.

The value of fossil fuel companies has not plummeted so we need to be clearer and sustainable finance is a part of that. Some politicians are less firm and still see a place for these companies. Fossil fuel companies are playing a game of chicken with humanity. They bet that if they lobby and keep the pressure on, the climate and sustainability agenda will go away. We have to be serious that their profits will not prevail over the future.

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Fossil fuel subsidies need to end immediately and fossil fuel lobbyists banned from stalking the corridors of power. In March 2019, I joined other Greens/EFA MEPs to call for the removal of ExxonMobil's access to the European Parliament. We need and higher taxes that make the polluter pay such as restoring the fuel tax escalator in the UK and introducing a frequent flier levy for the 15 per cent of people making 70 per cent of all flights. Ultimately, carbon taxes and carbon rationing is required to rapidly drive the transition away from fossil fuels.

Closing down the coal pits caused deep, long-lasting damage to regions and communities across the UK. What can be done to make sure the same thing does happen again to workers in the oil and gas industry?

The Greens were the first political party to advocate a Green New Deal some 10 years ago. Large-scale public investment will see the mass insulation of homes and buildings and a transport revolution with substantial investment in trains and buses, as well as cycling and walking. The research, development, and production of renewable energy resources are vital components of the Green New Deal. This potential can bring about a socially just transition with hundreds of thousands of quality jobs allowing for the transfer of skills from the dirty industries of old to the new green businesses of the future.

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Moving back to the world of finance, what can central banks do to make the financial system more ecologically sustainable?

Christine Lagarde, the new president of the European Central Bank, is responsible for the Systemic Risk Board. This board should already have carried out carbon stress tests on all European banks. We know that carbon assets are going to be eliminated within the next 30 years, so banks should be writing down the value of those assets and eliminating them from their holdings. I previously questioned Mario Draghi on this but so far the Systemic Risk Board has not done this part of its job.

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Quantitative easing is another major concern. It is absurd that the central bank buys fossil fuel bonds as part of measures to support the European economy [read more about quantitative easing]. What they should be doing is working with the European Investment Bank to create bonds to fund infrastructure such as the electrification of bridges and railways. If we're creating free money, it should go to the sustainability transition, not to the fossil fuel companies, which is what they've done for the past five years. The central bank jargon for this is market neutrality, but neutrality makes no sense when it means building up financial risk through the accumulation of stranded assets and, more importantly, risking the future destruction of humanity itself.

In recent decades, finance has not been sustainable, both ecologically and more generally. To what extent can we reform finance to avoid a future crash?

Reforming finance is not difficult; it is a question of political will. Most of what happens in the world of finance has no social value at all and is effectively gambling. A tiny number of people make profits by moving money, while only a small proportion of the European banking system touches the real economy.

The same risks and instabilities that led to the financial crisis are being built up again. Securitisation, chopping up and repackaging debt to obscure the risks, has been regulated by the EU. Our position was that securitisation should not happen full stop. People should not be permitted to gamble on whether other people will default on a mortgage or a student loan, as that gamble brings no social value and only builds in instability. Lessons were learnt after the past crash, but politically they have been ignored.

What institutions or concepts could be the pillars of an alternative green financial system?

It is not that we need new institutions, we need to overhaul the ones we have got. If the European Central Bank were to abide by its existing requirements, it would not permit products that create instability and no social value, including in terms of sustainability. Political will is needed from the regulators and legislators, and determination from the head of the central bank. Maybe Lagarde will. Education and culture change is also important. Most central bankers do not have a clue about sustainability. But sustainability and ecology should be prerequisites for working in a central bank.

The financial crisis created a strong movement that is now challenging the self-serving banking model. Public and cooperative banks play a significant role in the transition to a more stable and green financial system. It is encouraging to see a system of public banks embedded in local communities emerging. Banks such as the South West Mutual in the region I represent in South West England are necessary to make sure that when money is created we all benefit.

You have researched many of the people behind the Leave campaign. To what extent were some of the backers of Brexit motivated by their own financial interests? What are they hoping to get from Brexit?

Short selling thrives on volatility in the market. Companies and currencies need to be losing and gaining value for short sellers to make their money. When Michel Barnier comes out and says there'll be a deal, the pound shoots up in value. When a deal is looking unlikely, the value plunges. Forward information about those movements lets you gamble and make large amounts of money. Crispin Odey, a hedge fund manager who backed Brexit, made 200 million pounds on the night of the 2016 referendum. He found out at some point that Leave was going to win and he sold the pound. That is allegedly why Nigel Farage was on TV saying that Leave had lost. Conflicts of interest are particularly at play in the Brexit Party. It's worrying to see Richard Tice and Ben Habib elected to the committee that oversees financial regulation as there are clear conflicts of interest.

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The longer-term objective post-Brexit is to make sure that Britain no longer has to keep to EU rules on transparency and tax avoidance. Through its network of tax havens, Britain has always been at the centre of global tax avoidance but Brexit will make this even more the case.

Financial services are one of the UK's biggest industries. How can they be reformed in such a way to build on its expertise while curbing its excesses?

Reform will be difficult for the British finance sector inside the EU because the EU has not been strict enough in terms of the regulation, and the sector wants to compete. But outside the EU the alternative is worse. The British financial sector will look to cut standards and become an international pariah in terms of financial regulation. The financial expertise of the Square Mile should be managing the move towards sustainability and a zero-carbon economy in a financially stable way. Those people should be helping us adjust our regulation to insulate us from disasters, instead, they are profiting from them. The EU has not so far shown itself willing to make them change tack, but the UK will even lag further behind if Brexit goes ahead.

Molly Scott Cato is the first Green MEP for the South West of England and Gibraltar, elected in May 2014. She is a leading member of Green House Think Tank, and formerly professor of strategy and sustainability at the University of Roehampton. She has written several books, including *Green Economics* (2009), *Environment and Economy* (2011), and *The Bioregional Economy* (2012) as well as numerous academic papers. She is the candidate for the Bristol West constituency in the 2017 elections. You can follow her on @Molly4Bristol.

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