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Net Zero Is a Pipe Dream Without Total Inclusion

To really save the planet, we must help emerging markets go green. That means robust carbon markets, debt-for-climate deals and financing options to speed the transition.

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There is an incontrovertible and sobering fact about the drive to net zero. Any effort that doesn't work for the whole world will fail everywhere. A path that favors developed markets at the expense of others will lead to a partial net zero, which is no net zero at all.

Unfortunately, too many countries, companies and investors see achieving this goal by mid-century as a divided race against metrics rather than as a united race against time.

That's why it's imperative that the upcoming COP26 climate conference align and accelerate global efforts to do right by the planet. Buzzwords aside, it must generate agreement on a practical and fair transition path for all of the world's 7.9 billion people, most of whom live in emerging markets and will depend on dirty energy sources or industries for a long time to come without support.

The problem is clear. We are facing a massive gaming of the system, where it is possible to appear "clean" on a technicality while leaving emissions unchanged in the real economy.

Many public companies and investment managers are focused on a simplistic reduction of their own reported carbon emissions, allowing them to sidestep questions about their environmental impact and avoid becoming a target of climate activism. It looks good on paper – and many surely mean well – but does it really affect the kind of change needed to achieve global goals?

For example, some resource companies are divesting from carbon-intensive legacy businesses in order to get rid of the hassle. This could put those assets in the hands of less scrupulous owners, unaccountable to the public and with no plan to invest in reducing emissions.

Fund managers can play the game too, striving for "portfolio purity" by picking and choosing investments that make them look green without having to advocate for real-world carbon reduction. This explains why green equity funds tend to be overweight in technology stocks.

With this sort of math, we see perverse outcomes. For example, allocating more to three of the largest clean-energy producers – Iberdrola SA, Enel SpA and NextEra Energy Inc. – can actually hurt a fund's rating for carbon intensity versus a known benchmark because these providers still burn fossil fuels.

Similarly, a typical global equity portfolio can reduce its reported carbon intensity by 3% simply by slashing by 50% its exposure to Indonesia and the BRICS (Brazil, Russia, India, China and South Africa). This provides an incentive for institutional investors to avoid these countries, depriving emerging markets of capital at the very time they require an additional $2.5 trillion a year to finance their move to a greener economy.

Worse, emerging markets might even be punished for relying on their existing energy systems to generate the revenue needed to finance their transitions. Take the carbon border taxes proposed as part of European Union's ambitious "Fit for 55" package, and suggestions by European Commissioner Valdis Dombrovskis that trade policy could be used to enforce compliance with EU environmental standards.

It's all stick and no carrot. For coal-dependent trading partners like South Africa or Indonesia, such policies will undermine their position in the race to net-zero.

The approach is also a bit hypocritical. After all, OECD member countries are responsible for three-fifths of cumulative historic emissions, seven times more than the rest of the world on a per-capita basis.

Now that they have "offshored" substantial portions of that to poorer nations via complex supply chains, they owe them support and solidarity to move to a more sustainable – and eventually net zero – economy too.

Thankfully, there is a straightforward solution, but it requires creativity and not just the mechanistic application we've wedged ourselves into. It calls for readjusting the focus to "transition finance" rather than "net-zero finance." The purpose is pragmatism, not purity.

It is not about excluding the brown and favoring the green. It's about supporting the brown as it works to become greener, shifting the entire system at once so everyone has the means to reach net-zero emissions by 2050.

The rich world, with its substantial public and private financial firepower, must urgently create a compelling set of incentives for developing countries to embark on an ambitious energy transition. By all means, make the goals rigorous with verifiable milestones. We need as many carrots as sticks. If there was ever a time to put a monetary value to the ultimate public good, it is now.

That's why the rapid development and global scaling of voluntary carbon markets should be very high on the Group of 20's list of priorities. Besides facilitating the avoidance, reduction or removal of carbon, they have the potential to generate financial flows to those emerging markets which act as custodians of natural capital.

Importantly, once a deep and transparent market for various forms of carbon develops, the rich world can incentivize poorer countries to reduce their carbon footprint. Results should be rewarded with a combination of debt forgiveness and access to capital. Debt-for-climate deals are a double win, providing a financial solution to twin worries and one that's essential for developing economies to cross the net zero finish line.

We have no time to build new institutions. This means we need to repurpose part of what already exists to finance this tremendous, planet-saving undertaking. The private sector is ready and willing to be "crowded in." It cannot set the rules, but it can provide green finance at scale once those rules are set.

The need is clear. The investment opportunity is in the tens of trillions of dollars. With a fair and inclusive transition, the whole world wins.

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