

Push and pull economics of climate investor activism

Blog post by Chief Economist Gregor Irwin, 19 September 2019

Bill Gates says climate activists are [wasting their time](#) trying to encourage divestment from companies involved with fossil fuels. The impact on emissions to date, according to Gates, is probably zero. Instead, activists should focus their efforts on backing new technologies that will either slow carbon emissions or reduce their impact on the climate. In short, more financial push and less pull is needed by climate activists.

Does Gates' argument stack up?

Let's start with the basic economics. Divestment reduces the demand for a stock, or the supply of debt to the company that is being targeted. There is no getting away from the fact that this raises the cost of finance, assuming the scale of divestment is significant.

However, where some choose to divest for ethical reasons, others who are not concerned about emissions will sense a commercial opportunity and step in. They are the undisputed winners from climate activism of this sort, as they earn a higher financial return, which is what they care about. That, of course, takes the edge off the impact on the targeted company, but without eliminating it.

The consequences for emissions depend in large part on the capital needs of the company being targeted. And that depends in part on where the company is in the corporate lifecycle.

If the company is in a mature sector, that is not expanding, and does not need to finance major new capital outlays, then a higher cost of financing its balance sheet will damage its profitability, without really impacting on its operations and hence its emissions. Some big climate emitters, such as coal miners, fit into this category. The losers, when such companies are targeted, are the existing shareholders, who will see the higher cost of finance eating into their dividend stream.

The same isn't true when a company is growing fast and has high capital expenditure needs. If you raise the cost of financing the balance sheet, you don't just impact on profitability, you also change the economic incentive for that investment. Other things being equal, companies will do less if the cost of finance is increased. Some big emitters do still fit into this category, such as oil and gas companies who are active in upstream exploration, which is highly capital intensive.

The same logic implies Gates is right when he suggests that activists should be encouraging investment in new technologies that either slow emissions or mitigate their consequences.

These companies are almost by definition in immature markets and invariably have a high appetite for capital. But attracting that capital can be difficult, as they need to find investors who are willing to take on large risks, particularly as the technology involved is often unproven.

Taken together, these arguments imply that a focus on divestment from climate-damaging companies, in mature sectors at least, will often have a mostly distributional impact between investors. By contrast, encouraging investment in climate-friendly firms that are developing new technologies, and

which invariably require a large capital outlay, will impact more on economic activity that helps to reduce emissions. So, Gates is, perhaps, mostly right.

There is, however, a practical problem from following Gates' advice. It is one thing for activists to target big emitters that are easy to identify. It is also relatively easy to identify (and back) existing technologies that reduce emissions. But it is much harder to say where investment should be encouraged in unproven technologies with uncertain returns, both commercial and for emissions reduction or mitigation.

Just this week, the ECB's president-elect Christine Lagarde said the central bank could direct its corporate asset purchases toward green bonds should the EU agree a common framework for green finance. That caveat is important. Earlier this year, the European Parliament took the first steps towards defining a [taxonomy for sustainable investment](#), which may end up providing a partial solution to the information problem. The deeper problem, however, is that the question of whether a new technology is good for the climate is rarely a binary one and is instead a question of degree.

If that problem can be addressed, then perhaps the push-power of climate investor activism - in support of climate solutions - may well become a much more powerful force in the economy.