The need for carbon-neutrality

By Quintin Rayer | August 1, 2019

Unsustainable human activities have generated threats including climate change, associated with rising sea levels, extreme weather and flooding [1],[2]. Carbon emissions play a significant role in global warming, with current efforts focused on encouraging companies to report and reduce emissions. However, this may prove to be insufficient to meet the UN FCCC (United Nations Framework Convention on Climate Change) intended aims of holding the increase in global average temperatures to well below 2°C above pre-industrial levels while attempting to limit increases to 1.5°C [3]. What is needed is a definite move towards carbon-neutrality. Ethical investors can play a role by challenging company boards on their strategies to achieve net-zero carbon emissions [4].

Climate challenges

The UN FCCC aims already accept consequences from global warming, recognising that the risks and impacts of climate change would only be reduced, not eliminated. Thus, they may prove insufficient, particularly with slow uptake from international governments, and the potential for political pressures to delay or disrupt progress.

Current warming appears to be on track for at least 3°C by 2100 [5]. Emissions reductions of at least 40% by 2030 are needed to meet the 1.5°C goal, with net-zero emissions necessary for global warming to stabilise [6].

Progress is also inhibited by the ability of companies to externalise costs associated with carbon emissions. It is generally unlikely that companies are paying significantly towards atmospheric CO_2 reduction, or pricing the cost of CO_2 removal into their products. Typically, consumers may not pay prices reflecting the true cost of dealing with the CO_2 involved in products' production or use. Companies are left with little incentive to reduce emissions or to develop a strategy for achievement of carbon-neutrality [7],[8].

Carbon reduction

Reporting and reduction initiatives for company emissions (for example CDP [9]) are unlikely to meet the UN FCCC aims at current rates. Such initiatives are helpful steps in the right direction – but given anticipated population growth and economic development in less-developed countries, it is reasonable to question whether they are likely to be sufficient. Indeed, an expanding proportion of a growing world population will demand improved living standards as less developed countries modernise [8], leading to the potential for higher emissions.

There is a danger of a Malthusian trap, in which any spare capacity gained by decreases in carbon emissions will be taken up by population growth or increases in economic activity [10]. If carbon emissions are only reduced, the reduction is likely to be taken up by either increased global population or else by increased emissions per capita, resulting from improved living standards in less well-developed counties.

What is required is a clear movement by companies towards zero carbon emissions, or net-zero carbon emissions (NZCE) to achieve carbon neutrality, which at the current time companies appear to have been slow to adopt.

Ethical investing, sustainability and carbon

Ethical investors (including individuals, wealth managers and fund providers) can support such a move by influencing companies to develop NZCE strategies and screening investee firms based on their progress towards their development and implementation [4].

Sustainable investors already focus on environmental, social justice and corporate governance (ESG) issues [11],[12]. Within sustainable investing, environmental factors include climate change and the need to avoid the worst effects of global warming caused by excessive build-up of CO_2 in the atmosphere. Thus the need for carbon emissions sustainability sits squarely within an ESG investment framework.

How this helps financial advisers

Ethical investors need to start asking for investments in companies to be judged on the development and implementation of net-zero carbon emission (NZCE) strategies, in addition to current ethical and sustainability criteria. A push for NZCE forms part of P1's broader climate-friendly investment policies as part of an active engagement project with selected participating fund managers [4].

Sustainable investing, with low, or net neutral, carbon emissions in mind, is one way of encouraging companies to reduce carbon emissions. Media commentary shows that many sections of the public understand this message, even if the finance sector has been slower to adjust. Clients increasingly wish to invest ethically; the Investment Association reports £18.4 billion assets under management in the UK ethical funds sector in May 2019, a yearly increase of £1.9 billion [13]. Advisers must be confident that the wealth managers they choose to support the ethical and sustainable investing requirements of their clients have the necessary skills and commitment. The work that P1 has put into engaging with fund managers should also give advisers confidence we have the skills to support them in this significant and growing area.

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