How green is my central bank

The Bank of Finland has announced that its investment portfolio will be carbon-neutral by 2050. Reading up, I found many western central banks making similar announcements.

Puzzling. A central bank holds most of its investment portfolio in gold, and national and foreign cash and sovereign bonds. How would one judge whether bonds and cash assets were carbon-neutral? Gold, bizarrely, was excluded from the calculus of carbon neutrality apparently because there was no method to judge this. I find it inconceivable that gold mining is carbon-neutral, but let that pass.

The literature on the subject, putting it politely, completely misses basic tenets of government finance. Government revenues are not directly linked to expenditures. Governments do not spend to maximise tax revenue. This is equally true of debt-financed government spending. Even if such debt-financed spending is only used for capital expenditure, the portfolio of capital spending cannot be judged according to its carbon impact, since a large chunk of such investment is financial investment. Nor do they generate revenues solely to spend on acquiring goods and services, like households do. Further, a large chunk of government expenditures are transfers, which seek to influence the allocation and distribution of resources in an economy. These are financed by debt or taxes, but are not “spending” in the sense we use the term for firms and households. Unemployment benefit used to buy fossil fuels is bad for carbon but that does not make it carbon-positive.

Even if domestic debt is used to finance a high-carbon investment, there is no way any central bank can refuse to issue such debt as (a) it is not part of the mandate of a central bank to tell the government how to spend its money; (b) specific sovereign bonds cannot be earmarked to a specific investment activity as these are issued to finance a fiscal deficit and are therefore compositionally neutral. With foreign debt, the lack of a link is even more compelling: further the reasons why central banks acquire foreign debt have absolutely nothing to do with the purpose of issuance.

When central banks hold corporate financial assets then, of course, things are different. But the question then arises: Why do central banks hold corporate assets in the first place? This is a legacy of the bailouts that many western central banks have offered to their financial sector in times of stress. Evaluating the carbon neutrality of these highly iniquitous investments just compounds the scandal.

Green climate and other bonds, and fixed-income assets do offer an explicit and ex-ante guarantee of carbon neutrality. To the extent that these form part of sovereign issuance, their share in total borrowing could be used as a plausible metric. There are two problems with this. The first is that it detracts from the sovereign’s absolute power to receive fungible resources (whether tax or debt), which is an essential component of statecraft. Imagine war or pandemic finance being inhibited by the need to be carbon-neutral.

Still, some progress can be made as the recent Indonesian Sukuk issue showed. The second is that green financing does not guarantee green procurement or utilisation that is at least carbon-neutral. If a green bond is used to finance a railway project but the steel and electricity used to produce and run the railway are dirty, and the railway is primarily used to transport mining output, then can it be said to be carbon-neutral?

I suspect that central banks, having proved themselves so roundly incompetent at avoiding financial sector bailouts and traumatised by the collapse of their theological anchor — that financial markets are always efficient allocators of resources — and faced with the reality that no amount of independence will protect them from the impact of a US taper tantrum or a Chinese mega move — have occupied themselves with climate change as a diversionary PR exercise to mask the reality that they have increasingly become subordinate to an unequilising and unjust global financial system.

This silly posturing by central banks is yet another consequence of what I have been arguing is the whole problem with how green is viewed in the world of finance — as the only way to stave off prudential risk and suffering to rich people as climate change threatens their lives. This yet again bypasses the central problem. As the world has carbonised, a minority of people have been consuming too much and a majority too little. Without convergence in consumption patterns, there will always be opportunities for carbon spillovers. Unless the negative externalities of the consumption of the affluent are recognised and discouraged, with green investments leapfrogging prosperity gaps in poorer geographies, the climate change issue will not be effectively addressed.

Klaus Schwab, founder of the World Economic Forum, recently spoke eloquently about the danger global warming posed to his grandchildren in 2050 but the danger to a kid in a Bombay slum is being inundated in the next monsoon, not sea levels rising in 2050. But significantly accelerating the prosperity of that child would involve greater sacrifice on part of Dr Schwab’s grandchild for “our common planet” to be sustainable. Convergence in consumption patterns will involve less green consumption by the grandchildren of the rich, and more, also green, consumption by the grandchildren of the poor. Merely providing recycling and wind energy opportunities for the rich to perpetuate their unequilising lifestyles is not going to do the trick.

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