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SAFE Finance Blog

"The Next Few Years Can be Decisive"

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The time is limited to mitigate the possible consequences of climate change. In this interview, Holger Kraft talks about COP24 in Katowice, the strategy of the EU and the classification problem of green bonds



The UN Climate Change Conference (COP24) just came to an end in Katowice, Poland. You are concerned with the economic effects of climate change. How do you assess the efforts of the international community?

The problem is that the international community thinks in a very long time horizon. The negotiations are about goals for the next 30 years. This seems to be the lowest common denominator possible to achieve at the moment. However, many climate researchers think that the next 15 to 20 years could be decisive. I

have two concerns: first, this period is too long, and second, it is not clear whether the states will stick to the agreements at all. This is especially problematic because there are so-called tipping points in climate research. For example, if the global temperature rises above a certain limit, domino effects will follow. The climate change cannot simply be turned back then. Just one example: If the north of Siberia heats up as much as the permafrost soils thaw, large amounts of gases such as methane are released. This would have consequences for the climate, which cannot be readily reversed.

An important topic at the conference was to develop consistent and transparent standards to review and compare the greenhouse gas emissions of each state and their efforts to mitigate climate change. Why is that so difficult?

The big problem is to distinguish what is really sustainable and carbon neutral, and what is not? The gradations are difficult to capture. Not everything an automobile manufacturer is doing automatically is "not sustainable". On the other hand, take a producer of solar panels - there may also be service trips or other areas of the business that are unsustainable. Classification is currently a big issue in the financial industry because green bonds are also a very interesting market. The question is: how should CO2 emissions be taken into account there? There is a lot of political uncertainty about what happens in the future with CO2 emissions, whether they are taxed, for example. This is a complicated matter, especially in the case of financial transactions: Assuming that a bank lends a loan for the modernization of old heating systems, in terms of overall and climate economics, this certainly makes sense, but even then, the heating systems will produce emissions. Should the bank be penalized for indirectly being involved in these emissions?

Even before the summit, the EU presented its climate strategy. After that, it is aiming for a climate-neutral EU economy by 2050, with costs of up to € 290 billion a year. Is that a realistic goal from your point of view?

The time horizon is very long here too. It is interesting that already the perception in the EU is falling apart. Not all European states see the German climate policy as fully positive, because in our country, for example, we still hold on to coal-fired power plants. Germany, on the other hand, sees itself as a pioneer and is trying to get out of both coal and nuclear power in the medium term - making that at the same time is a very ambitious goal. In any case, a climate-neutral economy is a project that will require tremendous effort and huge amounts of money. Just think about the energy or the transport sector. Of course, we are talking about a lot of money here. If everything is not as bad with climate change as feared by some climate researchers so financial resources may have been spent in vain. If the negative scenario occurs after all, and nothing has been done, we may have a huge problem.

Germany lags behind its own climate goals. What would have to happen in your view for this to change?

Therefore, Germany would have to change the sectors massively that contribute particularly strongly to pollution: these are the energy and transport sector. Households and the industry sector are also a problem; virtually every area of life is touched. In short, you must first tackle the obvious and use the financial resources as efficiently as possible.

Do you think that technical progress could be a lever to limit the problems that climate change implies?

There are considerations to intervene directly in the climate and thus to reduce or slow down the warming. The so-called geoengineering can roughly be divided into two categories: First, these are technical measures to bind and store carbon dioxide from the air. The problem is that these ideas are still in

development and very expensive. Secondly, there are measures to reduce the amount of solar radiation on earth, for example by bringing more particles into the stratosphere - a similar effect to a volcanic eruption. I find that risk is difficult to calculate. These considerations can also be problematic if they lead us to rely too much on scientific progress and therefore neglect the necessary measures today.

Holger Kraft (<https://safe-frankfurt.de/research/researchers/researchers-details/showauthor/16-kraft.html>) holds the Chair of Asset Pricing at Goethe University Frankfurt.

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