



Sustainable investing and climate policies: Complements or substitutes?

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There is a broad consensus that public policies such as carbon taxes or cap-and-trade systems would be the most effective way to reduce global greenhouse gas emissions. However, often, such policies fail to find the required political support. Accordingly, there is a wide gap between the global ambitions to limit climate warming to 1.5°C and the public policies in place (UNEP 2023). At the same time, there is increasing pressure for climate action from investors. More and more investors expect their money to be managed in a way that promotes positive environmental and social change. However, current research suggests that the effectiveness of the current sustainable investing products in curbing externalities is limited. This raises the question of how sustainable investing and climate policies interact. Could sustainable investing do more harm than good by reducing the likelihood of implementing effective public policies? Or is there a positive reinforcement between the two? The following papers provide important evidence on these and related questions.

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Does sustainable investing crowd out political support for climate policies?

In an experiment with a representative sample of over 2,000 Swiss voters, we show that the option to invest sustainably does not crowd out individuals' support for climate policy [Heeb et al. \(2024\)](#). We leverage a public referendum on a crucial climate law in Switzerland for the pre-registered experiment. Participants receive the opportunity to invest in a dedicated climate fund. While a large majority takes this opportunity, this does not reduce their willingness to donate to a campaign engaging for the climate law, compared to a control group that could not select a climate fund. We show that our experimental findings are broadly consistent with

real-world observations based on data we collect on voting outcomes, sustainable investment behavior, and campaign donations. Our findings clearly do not support concerns that voters see (potentially ineffective) sustainable investments as a substitute for political engagement. If anything, our results suggest that sustainable investing may have a small crowding-in effect on individuals' support for more stringent climate policies.

The role of financial engagement

While in [Heeb et al. \(2024\)](#), we find a significant relationship between likeliness and political preferences, [Anderson & Robinson \(2022\)](#) show that this is not necessarily the case in other settings. The authors survey a sample of around 4000 Swedish households to measure their pro-environmental attitudes. They then connect their survey results to comprehensive datasets on stock ownership and pension fund holdings of these households. Strikingly, they find that households with a pro-environment attitude are not more likely to hold pro-environment investment portfolios. The authors show that this finding is likely caused by financial disengagement. Pro-environment households are less likely to participate in stock markets or actively choose (green) pension fund options. However, the relationship between pro-environmental attitudes and green investing is stronger in households with high financial literacy and when informational hurdles are lower. In contrast, pro-environmental households with low financial literacy are more drawn to investment products with green-sounding names. Thus, an interesting implication of the study is that greater transparency and ESG-related information may lead to a stronger connection between political attitudes on environmental issues and investment decisions.

Green investments and emission caps

[Biais & Landier \(2022\)](#) show that there might be positive reinforcements between sustainable investing and public climate policies. In an equilibrium model, the authors investigate the interactions between corporate investments in “green” climate-friendly technologies and governments' ability to impose greenhouse gas emission caps. They assume that the government maximizes social welfare but has limited abilities to commit to strict emission caps. They find that both a positive and a negative feedback loop are possible. If firms anticipate that the government will impose emission caps, they are more likely to make up-front investments in green technologies. These investments, in turn, reduce the cost of emission reductions for other firms and, with that, reduce the political cost for the government to implement the emission caps. On the other hand, if firms expect that emission caps will not be implemented, they do not make green investments, which increases the political costs of emission caps and makes it less likely that the government will enact them. Given these different possible equilibriums, the authors argue that if there is a sufficiently large sustainable investment fund pressuring firms to

make green investments, this fund could tilt the equilibrium towards a positive feedback loop. Thus, even if sustainable investing may not be highly effective in directly reducing greenhouse gas emissions, if it encourages firms to make green investments, it may indirectly increase the likeliness of (potentially more effective) climate policies.

Carbon pricing versus green finance

In an equilibrium model including both carbon pricing policies (e.g., carbon taxes, cap and trade systems, or carbon offsets) and green investing, Pedersen (2024) explores how these two approaches to fighting climate change interact. He shows that green finance is not optimal if there is a global carbon tax that matches the social cost of carbon emissions. Further, the author shows that if the price of carbon emissions is below the social cost, green investing can nevertheless achieve the social optimum. This requires two assumptions: First, that green investing is indeed able to control firms' cost of capital effectively, and second, that there are no "stranded assets," i.e., high emitting assets that will keep emitting irrespective of firms' cost of capital. Analyzing carbon pricing policies around the world, the author shows that these are widely below the social optimum and vary strongly. He concludes that a combination of different tools, including carbon pricing and green investing, while not optimal, might be a pragmatic second-best approach.

References

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