



Sustainable finance is the way out of crisis

Simon Zadek, 29th August 2011

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S&P, in downgrading the USA, made the right call for the wrong reason. Keynesians like Jeffrey Sachs see this but need to go even further: the developed world will come out of recession only when the mighty engine of finance turns to the task of developing a sustainable future. And that faces political, not economic obstacles

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History will wrongly vindicate Standard & Poor's in downgrading their view of US creditworthiness, because they made the right call for the wrong reason. S&P missed the real story behind the story, the US's failure to grasp the new economic realities for the 21st century.

For S&P, the downgrade is about shortfalls in macroeconomic policy and debt management, scuppered by a worryingly myopic political process. Jeffrey Sachs rightly dismisses this as superficial ('[Tripped Up By Globalisation](#)' [8], FT), arguing that the fundamental problem is that the US (and Europe) have failed to develop vision, strategy or practice that can drive economic growth in the face of the vitality and growing competitive advantages of emerging nations from Chile to China. Sachs' analysis and recommendations illuminates the inappropriate policy focus on the short-term. Yet his analysis falls short of his own measure of success in failing to uncover root cause. As a result, his liberal Keynesian solutions – more public infrastructure, investment in people, less spending on military follies, and impactful taxing of corporates and rich – whilst well-meaning and certainly progressive, fall short of what is needed.

Economies will only succeed if they can flourish in a natural resource-constrained world, and rid themselves of the current winner-take-all mentality and outcomes. Smart policy folks from Washington to Brussels get this, but cannot translate their insights into action. Much of the problem lies at the nexus between corporate power and policy making. Incumbent US business interests have killed off any meaningful global climate agreement and succeeded in rolling-back numerous domestic attempts to price carbon and other eco-services. Such actions have prevented the US's world-class financial services sector from doing what it does best - investing; in this context, investing in the vast potential underlying a transition to a green economy, a pre-condition for US economic success.

Sachs wants governments to raise taxes from folks who can afford it and spend them on the right things. Fair enough, but the real money is in Wall Street, not in anyone's fiscal coffers. Global financial assets were US\$150 trillion in 2010, topping pre-recession levels for the first time. Yet barely US\$150 billion was invested in 2008 in clean technology projects and companies, a small fraction of the estimated global investment needed in green infrastructure of several trillion dollars annually. Our economy is unsustainable because our financial markets allocate capital to businesses that are unlikely contenders for leading roles in a sustainable economy and are too often actively working to prevent its emergence.

Today's financial crisis and accompanying recession is the map, not the territory. We can only



leverage the current crisis if we see in it the signposting towards the need to realign financial markets, rapidly and at scale. Financial market reform understood in today's conventional terms is focused on how best to ensure the 'resilience' of financial markets, to prevent them imploding once more and causing economic havoc and social misery. Whilst clearly important, this lens ignores the underlying imperative to secure the resilience of the global economy in the light of natural resource and climate challenges and the destabilising effects of endemic inequality and poverty. This is crucial both to secure robust financial returns to intended beneficiaries, pensioners and the like, as well as addressing the broader public purpose of financial markets. Those who take the high road will embrace Joe Stiglitz's argument that, "finance is a means to an end, not an end in itself. It is supposed to serve the interests of the rest of society, not the other way around".

Overcoming short-termism is a pre-condition (although not sufficient) for progress as the ingredients of a sustainable economy will count for more when investors consider the long-term performance of prospective investments. [Andrew Haldane](#) [9] at the Bank of England, with Richard Davies has offered compelling evidence that investors are increasingly turning away from profitable investment opportunities because of their distorting appetite for short-term profit-taking. Fund managers are perversely incentivized towards short-termism, and this has not got any better as a result of painful lessons from the financial crisis, a point confirmed in a recent study published by leading executive remuneration experts, [Mercer Consulting](#) [10]. As economists would have it, there are major market failures in the financial sector that need fixing.

Sustainability-aligned investment practice has matured into a credible, profitable niche market. Whilst such practice should be encouraged, it's incremental growth cannot be relied on to overcome the gross misallocation of capital at the requisite scale and pace. Regulatory and fiscal interventions have to be considered. Currently fashionable is the proposed financial transaction tax, that if carefully designed and broadly embraced might reduce the relative profitability of rapid financial trading. But this so-called 'Robin Hood Tax', advocated by President Sarkozy and now also Chancellor Merkel, may not get off the ground or fail at take-off because of an opportunistic focus on revenue-raising rather than incentive shifting. Other policy interventions being tested in real-time today that might serve to reduce short-termism include bans on naked shorting, penalising taxes on non-resident currency trading, sustainability-aligned tracker indexes and investor governance codes. Greater investor disclosure will also help, for example, on how climate change is being factored into investment strategies. Realigning the basis on which sovereign and also corporate credit ratings are established would be a critical driver for directing assets towards sustainable economies and companies.

Jeffrey Sachs is right in calling out the structural nature of the challenge at hand. But needed is a policy debate that focuses on overcoming the root causes of why political economies are failing to shape up for the 21st century. Anything less is a dangerous distraction that will seal our fate in over-looking the current opportunity. Such causes and policy solutions are of course not exclusively about the investment community. But unless financial markets are reset, it is hard to see anything else making much headway.

Such root and branch analysis, ambition and action must characterise our broader response to S&P's misguided success.

Topics: Economics
Equality



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