

ESG investment, Various Environmental Policy Tools and Their Equivalence

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Abstract

This paper examines the current landscape of Environmental, Social, and Governance (ESG) investing by focusing on “E (Environment)” issue. We analyse the discrepancies in ESG scoring methodologies among different rating agencies and demonstrate how these inconsistencies can lead to distorted investment decisions. To address this issue, we propose a unified approach based on net carbon tax, which incorporates both carbon emissions and companies' green efforts. We address that carbon trading, carbon pricing and green bonds are different across various countries. This can lead to distortions of production location since global companies relocate their production units based on tax rates and various fees.

We also explore the potential alignment of carbon tax, green bonds, and carbon pricing mechanisms. We argue that by standardizing the measurement of greenhouse gas emissions, these instruments could converge to provide consistent signals for investors and policymakers. Burdens and consequences of each policy will differ which will cause relocation of global companies based on weaker regulation on environments.

Additionally, we discuss the importance of including small and medium-sized enterprises (SMEs) in emission reduction efforts, and the potential implications of central banks purchasing green bonds. We have also offered key messages for policy makers in Asian countries.

< Conclusion >

This paper has examined the current challenges in ESG investing, particularly with regard to environmental scoring, and proposed a unified approach based on a net carbon tax system. By standardizing the measurement and evaluation of companies' environmental impact, this approach has the potential to significantly improve the efficiency and effectiveness of green finance initiatives. Unifying the measurement and rating approach across countries also has the benefit of avoiding distortion of production locations and providing consistent signals for investors and policymakers. Our key findings and recommendations include:

1. The current ESG scoring system leads to inconsistent evaluations and potentially distorted investment decisions.
2. A net carbon tax approach provides a more objective and standardized measure of environmental impact.

3. This approach can be aligned with other green finance instruments, such as green bonds and carbon pricing mechanisms, to create a more coherent framework for sustainable finance.
4. The inclusion of SMEs in emissions reduction efforts is crucial for comprehensive climate action.
5. Discourage central banks from issuing or investing in green bond markets.
6. While all instruments ultimately place the financial burden on the private sector, they differ significantly in how funds are channelled. Carbon tax and sovereign green bonds could help create new revenues sources for the government.

By adopting these recommendations, policymakers and financial market participants can create a more effective and transparent system for promoting sustainable economic practices and addressing the urgent challenge of climate change. Ultimately, the transition to a sustainable, low-carbon economy will require coordinated action from governments, financial institutions, businesses, and individuals. The unified approach proposed in this paper aims to provide a clear and consistent framework to guide these efforts and accelerate progress towards our shared environmental goals.