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Is the adoption of Sustainability Financing an effective solution to environmental issues?

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Abstract

With the growing use of green financing, environmentally conscious banks and investors can help incentivize firms to create more sustainable business practices.

This poster aims to provide insight on how effective green financing is on lessening CO_2 emissions and improving the environmental and social responsibility of the firm. The results indicate how complex the issue is. While green financing certainly lessens a company's environmental impact, it also lacks clear guidelines, reducing its potential benefit.

Background

As countries turn their attention towards the mitigation of climate change, the role the financial sector must play has become more and more important. Green bonds are investments that are used to finance projects that are environmentally friendly or reduce a company's carbon footprint. The same is true with sustainability loans.

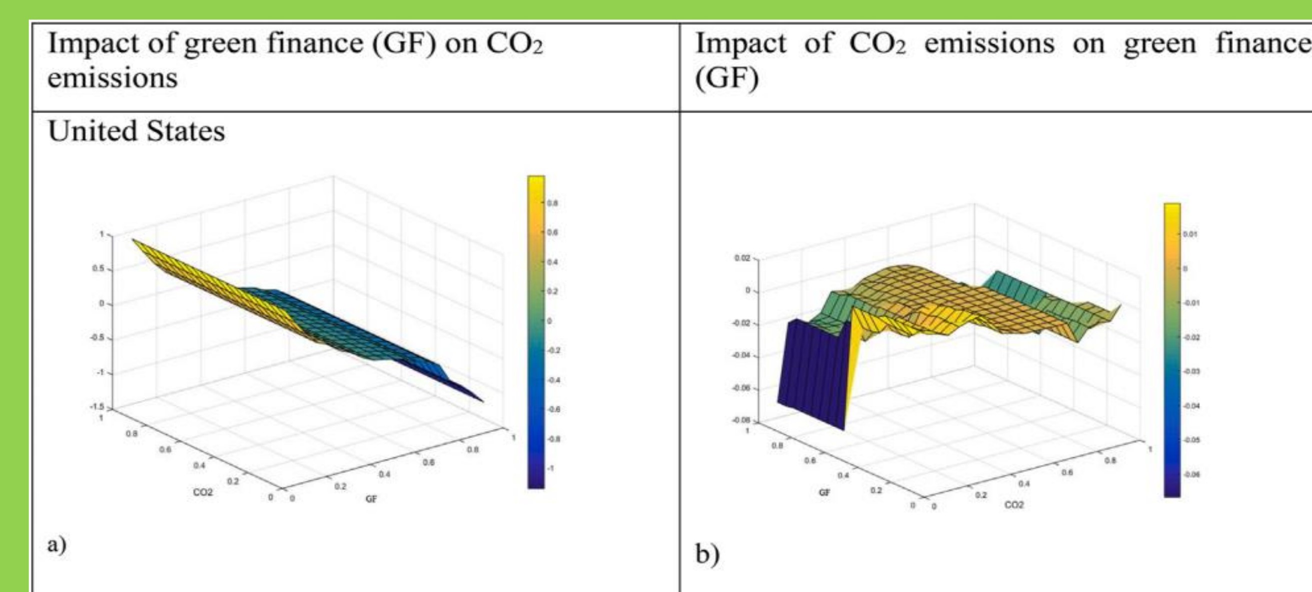
Companies may not be making the changes to help the environment because it is not to their benefit to do so. With the introduction of sustainability financing, green finance providers hope to drive this change by incentivizing companies with investment. However, the question remains: how effective is sustainability financing in solving environmental issues? Is it an effective solution to the climate crisis?

Findings

Is there evidence that an increase in green financing leads to reduced CO_2 emissions?

Depending on the country where green financing is being implemented the correlation between green finance and CO_2 emissions is either positive or negative. In Hong Kong and the US there is an overall negative correlation between green financing and CO_2 emissions while in smaller countries the efficacy of green financing is much weaker. The returns on green finance are also influenced by the size of the bond or loan. Smaller loans may lead to positive correlations while larger loans tend to reduce the impact of CO_2 emissions.

Despite this variance in results the overall recommendation is that green finance is still a worthwhile option in helping reduce CO_2 emissions.



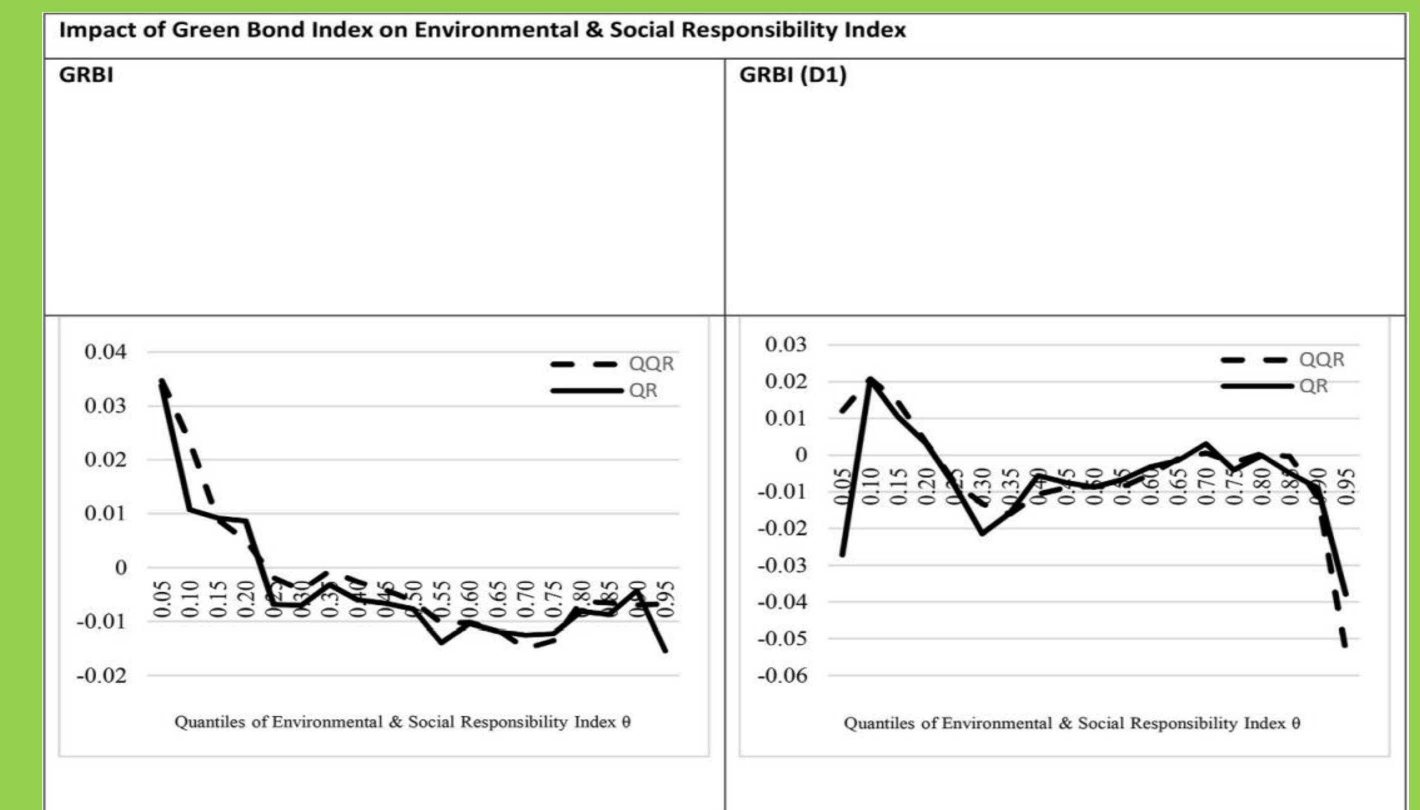
This graph depicts the estimated correlation between green finance and CO_2 emissions.

Another question that is very important to ask when discussing sustainable finance is how much does green finance impact the environmental and social responsibility of a firm?

Looking at the effects green financing has on these variables; the larger green financing becomes it also begins to lose its total overall impact on environmental and social responsibility.

This could be because firms are more interested in the economic growth proposition that green financing offers rather than continuing to pursue the improvement of socio-ecological issues.

Even so, green financing is required For investing in eco-friendly projects and to help divest from non-renewable energy into more clean energy. So why are green bonds making less of an impact the more valuable they become?



This graph depicts the impact of the Green Bond Index on the Environmental and Social Responsibility Index. Green bonds certainly influence environmental and social responsibility, but more policy would be required to sustain both while accomplishing environmental protection objectives.

There are no well-defined rules that measure the environmental impacts of a firm's projects. Firms will generally opt for maximizing profits even if the bond/loan is meant for creating a greener company.

Most firms will prioritize their economic output before the improvement of their socio-ecological output, and as green financing slowly loses its impact on environmental and social responsibility the usefulness of green financing also begins to diminish. If green bonds continue to grow rapidly while ecological goals remain relatively unmet, the impact of green finance may even become detrimental.

Conclusion

While green financing is shown to reduce CO_2 emissions in most countries where they are implemented, policymakers must ensure that the environmental and social outcomes of green financing are properly fulfilled.

If companies are more strictly regulated on how climate mitigation financing is used and how impactful the project is on creating a more environmentally friendly and sustainable company, then green financing has a place among a growing list of tools we can use to combat environmental issues.

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