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The Market Already Knows: Climate Action Is Economics 101

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Energy

The US Treasury Secretary Steve Mnuchin and his wife Louise Linton may disagree about Greta Thunberg's need to go to school to take economics classes, but a player often thought to have perfect foresight is in total agreement with Greta: the market is long on climate action. How else to explain that it sees an effectively bankrupt company as the most valuable car company in the world?

Tesla as a business enterprise may well completely fail but the market sees a powerful future for electric cars, the sole point of which is to reduce carbon emissions. Just ask anyone who has tried a long electric powered road trip—high performance internal combustion vehicles are hugely more practical, yet consumers are going electric and the market clearly sees a major transition away from gasoline powered transportation.

Mnuchin's predecessor Larry Summers certainly had a point when he said "there are idiots, look around" in his famous commentary on the efficiency of markets, but I'll take the market over any US Treasury Secretary in smelling a shift in consumer sentiment. This is the sort of stuff the market gets right, if perhaps not the actual stock to pick.

Climate action will be big business, perhaps among the biggest in the years and decades to come. Not that saving the planet and human civilization along with it requires a profit motive, but in the world's current capitalist system it will certainly help. And while electric cars are for now just the shiny object of climate action, given that they still may have higher carbon footprints than efficient gasoline powered vehicles due to the share of power generation still using coal country to country and region to region, the market's move to climate action goes much deeper than Tesla.

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Beyond Tesla and below the recent headlines such as the very public stance taken by BlackRock's Larry Fink and Microsoft's carbon negative by 2030 pledge, we see companies of all types seeking to reengineer their operations as lower carbon, carbon neutral and carbon negative. This is critical as industrial sources of carbon emissions account for 21% of all greenhouse gas emissions, agriculture, forestry and other land use is at 24% while transportation, where electric cars are intended to impact, accounts for merely 14%. Interestingly, all energy accounts for only 35% of the total. Buildings complete the emissions pie at 6%.

Industrial and commercial activities combined produce 45% of all greenhouse gasses, three times the amount as transportation and almost a third more than all energy. These are activities such as the production of steel, which is needed for example for electric cars and wind turbines, and fertilizer to produce crops to feed the world's people. The good news here is that these carbon emissions come from thousands of points and not the billion tailpipes of the global automotive fleet or the billions of homes around the world. The further good news is that addressing these emission points does not require punitive personal individual action. The solution is in a transformation in how these activities are undertaken and that transformation is already afoot.

Consumer sentiment is playing a role as is government policy, both current and anticipated. Many of the steps being taken are to align activities to current government policies from carbon pricing in some global markets to sub-sovereign regulations such as those adopted by California, the most populous state in the United States. Moreover, financial planning for new projects are taking into account the possibility, even the likelihood, that further government restrictions will fall into place. While the United States Congress is unlikely to pass a carbon pricing scheme any time soon, financial projections are nevertheless considering that possibility making reduced carbon output a financial imperative to get some new projects financed.

Industries from mining to chemical production are demanding of their operators, plant designers, and energy and materials providers give them lower carbon solutions. Not only are pricing regimes driving this but also consumer demand. While the general public may not be ready to give up meat or alter their driving habits, consumers want green and greener products. The concept of "blue" products—products made with carbon capture as a component—is also catching on.

Make no mistake, reaching the Paris Agreement targets, let alone a deep decarbonized society, will require more than consumer driven free market action. Carbon pricing will play a leading role in the transition as will infrastructure build-out along with innovation. But we are long past the point of seeing climate action as uneconomical. Failure to act will be even more costly than action and there is money to be made in the action. You don't need to believe Ms. Linton. The market is screaming it at us every single day.

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