Europe greening the world: the "Brussels effect" on sustainable finance

By

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Europe delivered two groundbreaking initiatives last week to counter the global climate change crisis: a European Union climate deal, committing the EU to more than halve greenhouse gas emissions by 2030 and reach zero net emissions by 2050; and the publication of a first-of-its-kind of regulation, the EU's sustainable finance taxonomy, with the potential to become the gold standard for global investors in green finance.

Governments, enterprises, and investors are increasingly conscious of the sustainability risks our economies and societies face. While the Covid-19 pandemic poses a grave short-term risk, climate change presents the most severe long-term challenge.

One of this blog's authors, Anu Bradford, coined the term "the Brussels effect"[1] in 2012 to explain how regulations drafted in Europe shape the global marketplace. In this blog, we explain why Europe's actions to encourage Environmental, Social and Governance (ESG) investment practices could lead to a new global standard for sustainable finance, transforming global capital markets in the process.

Sustainability risks pave way for ESG growth

The World Economic Forum's recent annual risk reports identified climate change and infectious diseases as top threats facing humanity.[2] Both risks present policy-makers and companies worldwide with enormous challenges, but also with opportunities to reset priorities.

The EU is transforming these risks into opportunities by embracing a sustainable recovery agenda. This includes deploying innovative funding instruments to help industries evolve towards sustainable practices and re-orienting investment towards resiliency projects.

There has been a steep rise in public, corporate, and investor awareness of ESG-related risks in the last half decade[3], which is also reshaping the capital markets landscape. ESG investments are one of the fastest-growing asset classes worldwide; they expanded exponentially during the pandemic and are expected to continue to do so during the forecast recovery phase.

Figure 1: Global sustainable bond issuance volumes