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Green finance: Beyond transparency

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Green Economy on Point.

Green Finance – Beyond Transparency

Sören Hilbrich & Kathrin Berensmann

Summary

- Financial markets still provide financing on a large scale for investments in environmentally harmful activities, while projects conducive to the green transformation are often not funded.
- Sustainable finance policies, such as new reporting requirements and standards for sustainable financial instruments, have so far mostly focused on creating transparency. However, transparency alone is insufficient to turn the financial sector from a driver of environmental crises into a lever for the green transformation.
- Many countries of the Global South face special challenges, including high interest rates, currency depreciation and limited opportunities to shape global policies (e.g. banking regulations and standards for sustainable financial instruments) in their interests.
- Aligning financial markets with sustainability objectives requires a comprehensive policy mix comprising policies that change incentives. These policies can include credit guidance instruments such as credit targets, green refinancing schemes and differentiated capital requirements, and tax policies such as differentiated capital gains taxes for green and non-green assets.
- International forums, such as the Network for Greening the Financial System (NGFS) and the Sustainable Banking and Finance Network (SBFN), remain valuable for mutual learning and for addressing cross-border effects of financial regulations.
- Policies to mobilise private resources should not be considered as a substitute for public investments or public steering, which are both crucial for the green transformation.

Financial markets are not aligned with sustainability objectives

The financial sector remains fundamentally misaligned with a sustainable economic trajectory. For instance, global energy investments in oil, gas and coal totalled approximately USD 1.1 trillion in 2025, far from the steep decline required (Figure 1) (IEA [International Energy Agency], 2025, p. 6). Non-sustainable investments can create lock-in effects and systemic financial risks. Meanwhile, projects conducive to the green transformation are often not funded. Financing is necessary, for instance to change production processes, invest in resilient infrastructure, reskill workers and protect natural sinks and biodiversity hotspots. The reasons for this misalignment include the nature of many environmental harms as external effects of economic activities, widespread short-termism of market actors in the financial sector, and information asymmetries. In

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addition, irrational herd behaviour of market participants can, for instance, lead to the underestimation of transition risks and cause carbon bubbles.

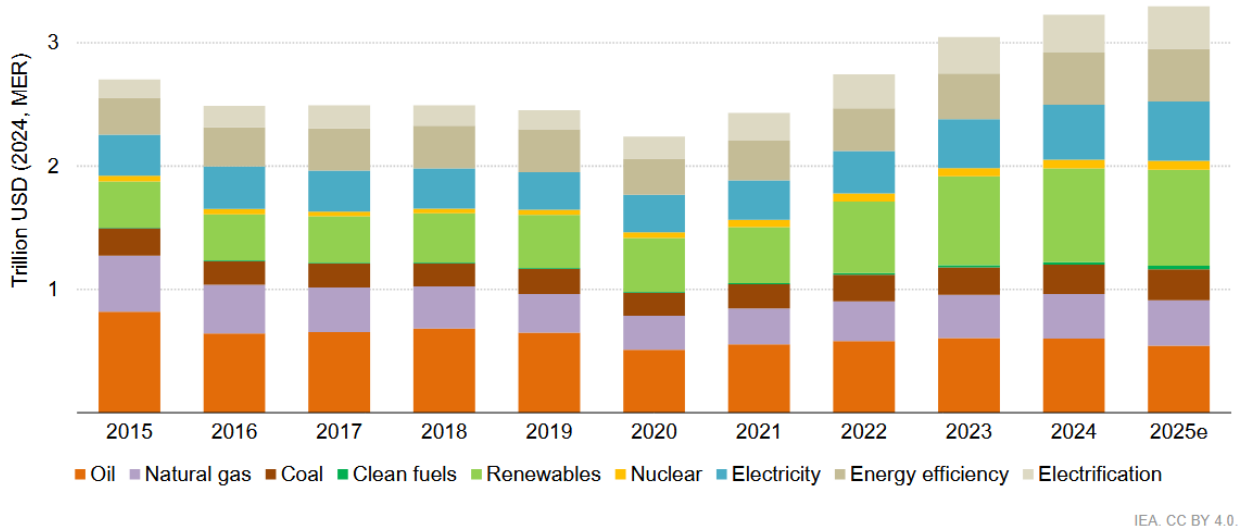
Many countries of the Global South face particular challenges in financing the green transformation. Regarding financial regulations and standards, smaller and poorer countries are usually rule-takers and have to adapt to rules that have been decided on in other jurisdictions or in international institutions and are often not well-suited to their respective contexts and interests. High interest rates, depreciating currencies and declining official development assistance (ODA) flows reduce the fiscal space for public investments in the transformation. Governments and firms in climate-vulnerable countries face especially high costs of capital, which reduces their capacity to invest in climate resilience (Beirne et al., 2021).

Current sustainable finance policies are insufficient

Over the last decade, policy-makers have started to introduce measures to align the financial sector with sustainability objectives. For instance, regulators have established new reporting obligations and sustainable finance taxonomies to provide investors with additional information. Furthermore, standards for sustainable financial products, such as green bonds, have been developed to increase the credibility of these instruments. Sustainability risks play an increasing role in financial supervision, and many central banks have started to understand sustainability issues as being closely related to their mandate. However, in recent years, we have seen a backlash against such policies in some jurisdictions, such as the US and the EU.

Yet even if policy-makers stick to the current sustainable finance agenda, the policies implemented so far would not shift investment patterns at the necessary scale. Currently, the majority of measures focus on creating transparency – and do not even always succeed in this respect (Hilbrich et al., 2025). However, transparency alone does not necessarily change investment behaviour (Ameli et al., 2020). The current focus on creating transparency thus risks adding bureaucracy without having a strong steering function (Hilbrich, 2026). In addition, mobilising resources for sustainable projects does not automatically curtail financing for “dirty” projects.

Figure 1: Global investments in energy, 2015-2025



Note: Values for 2025 are estimated. “MER” stands for market exchange rates. “Clean energy” includes “modern bioenergy, low-emissions H2 based fuels, and CCUS associated with fossil fuels and also includes direct air capture” (IEA, 2025, p. 13). “Electricity” includes investments in electricity grids and storage.

Source: IEA (2025, p. 13)

Finally, the idea of mobilising private resources for sustainable development, including through de-risking policies, is often presented as a potential substitute for public investments (critically described by Gabor, 2021). However, following this narrative can lead to a dangerous "outsourcing" of decisions on the pace and direction of the transition to private financial market actors (Kedward et al., 2024; Smoleńska & van't Klooster, 2022). In addition, this approach neglects crucial aspects of the transformation that are not associated with sufficient monetary returns, are too long-term or require projects that are too small or are (perceived as) too risky to be "bankable" (Aguila et al., 2026).

Towards a comprehensive policy mix beyond transparency

To address some of the shortcomings of current sustainable finance policies, we recommend action in three areas:

1. Aligning the financial sector with the green transformation requires policy-makers to *move beyond creating transparency and make use of the full range of policy tools*. Several instruments are available to financial regulators and central banks to change incentives. These instruments should be used not only to incentivise green investments but also to stop the financing of "dirty" projects. Potential policies include credit guidance measures aimed at steering banks' lending practices. In this respect, regulators can set targets for the share of green credit provided by banks, central banks may offer preferential refinancing conditions for green projects relative to non-green ones, and capital requirements could differentiate between green and non-green loans. Although such measures come with challenges, experience to date has been encouraging, for instance with credit targets and green refinancing schemes in Bangladesh (Hilbrich et al., forthcoming). In addition, central banks can influence markets by greening their own portfolios, as several have already begun to do.

   Some of the proposed changes to central bank policies and financial supervision could be implemented by decision-makers within these institutions under their existing mandates. This may enhance the political feasibility of such measures, even in jurisdictions currently experiencing a backlash against sustainability policies in the broader political arena. Furthermore, the ongoing energy crisis underscores the supply chain risks and inflationary pressures associated with fossil fuels, providing decisions-makers with an additional rationale for action, even from a monetary and financial stability perspective.

   Tax policy can also be a lever to change incentives, for instance through a green financial transaction tax or differentiated capital gains taxes for green and non-green assets. In times of tight public budgets and decreasing ODA flows, the promise of additional tax revenue could increase political feasibility.

2. On the international level, *cross-border effects of financial regulations need to be addressed*. Ongoing efforts, such as the Taxonomy Roadmap Initiative (2025), to increase the interoperability of the plethora of new frameworks and potentially achieve a mutual recognition of standards and taxonomies can be beneficial. Coalitions of the willing such as the Network for Greening the Financial System (NGFS) and the Sustainable Banking and Finance Network (SBFN) are helpful to advance the green finance agenda and foster mutual learning. International institutions and forums where sustainable finance policies are discussed should have a broad representation to bring potential unintended consequences of policies in different world regions and for different stakeholders to the attention of decision-makers.

3. The idea of *mobilising private resources should not distract from the crucial role of public spending* for an effective and socially just transition. Building state capacity to raise and efficiently allocate public funds is challen-

ging but indispensable. To increase *fiscal* space, governments can, for instance, remove fossil fuel subsidies and tax environmental damages. Specialised transformation funds with borrowing powers can, depending on a country's debt situation, also be used to raise resources for public investments (Golka et al., 2024).

Public development banks are currently experiencing a revival and should be scaled up to enable them to provide strategically important investments for the transformation. They can also support the development of local currency capital markets. Capacity-building by international actors, such as multilateral development banks and experienced development banks from other countries, can help establish operationally independent and accountable institutions capable of effectively fulfilling these roles.

These proposals focus on mobilising domestic resources, which is crucial, particularly given the currently challenging political climate for international public climate and development finance. However, the responsibilities associated with historical emissions will not disappear, and advocating for increasing international climate and development finance also remains essential for advancing climate justice and strengthening global climate policy.

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Green Economy on Point *is an IDOS series of policy briefs and webinars exploring today's pressing sustainability transformation challenges and emerging opportunities, with a focus on low- and middle-income countries. Bringing together new research and expert dialogue, the series explores transformative policy levers – from financial regulation and carbon pricing to green standards – and covers key sectors including hydrogen, green steel, fertilisers, sustainable buildings, construction and food systems. The series highlights innovative and actionable solutions for national and global policymaking.*

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