

# 04

## Shaping a climate-smart and eco-friendly business environment

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Adjusting the business environment of a country or territory to the new realities of climate change and environmental degradation is a complex and long-term process. This cannot be done on a project basis, but needs to be a permanent process led by national and regional actors. It also requires a solid understanding of how economies evolve and change (see article *Green Economic Development as an evolutionary process*).

The shape of the business environment strongly influences the behaviour of businesses in a way that could be considered climate smart and eco-friendly. The enabling environment for businesses is shaped by government-created factors that range from generic and sector-specific laws and regulations to service delivery, including development services. However, the business environment is not only formed by a government's economic development and industrial policy, but also by initiatives from the private sector to interact and innovate in order to strengthen the competitiveness of a given economic sector or the business community in a locality in general.

The behaviour of economic actors can be influenced in

three different ways: through pulling, pushing or enabling. Together, pull, push and enable instruments shape the evolutionary landscape for business to experiment with different product, process and business model innovations or even to switch to a more circular model of resource use (see article *From value chains to circular economic systems*).



**Figure 2:** Shaping a green business environment: pull, push and enable

Source: adapted from Schoen , C. 2014



To “enable” enterprises to become more eco-friendly, typical tools are applied to address knowledge, skills and relevant transformation processes concerning green technologies. These could, for instance, include information campaigns on cost-advantages and opportunities to turn enterprises into green, eco-efficient businesses, or awareness creation of climate risks upstream and downstream of value chains. However, the support of eco-labels and voluntary industry standards for environmentally friendly products (see article *Can standards help developing countries phase into a green economy?*), or setting up and maintaining a database of eco-friendly technologies, are also part of this family of enabling instruments.

“Pull” instruments target the sensitivity of businesses to prices and costs and hence influence the economic and financial decisions of firms. Financial incentives and disincentives are created to pull businesses in a

certain direction. This is often done by internalising the non-market, social costs of environmentally unfriendly behaviour, e.g. burning fossil fuels, or by making eco-friendly choices cheaper, e.g. by subsidising particular green technologies, or more lucrative, e.g. by feed-in tariffs for privately generated green energy. Market-based instruments, such as systems of carbon trading in combination with a quota approach that sets a cap on permitted emissions, are an attempt to influence enterprise behaviour in both developed countries (raising the costs of carbon emission) and in developing countries (lowering the costs of implementing green technologies). On the demand side, the public sector can make a deliberate choice only to buy products and services that are eco-friendly and climate smart in production and/or usage, thus favouring green enterprises over others through green procurement procedures.

“Push” instruments do not provide choices, but clearly tell enterprises and other economic actors what to do and what to avoid. Launching and enforcing environmental regulations or introducing green governance within the steering structures of the economy define boundaries for economic activities and their results.

The article *Driving forces for greening urban and rural locations in the EU* in this Annual Reflection gives examples of knowledge and skills (enable), policy and regulations (push) and finance and economics (pull) factors that define the EU’s efforts for a green transformation.

However, it is far from easy to establish these instruments. In the case of both pull and push instruments, there is a considerable risk that they may create unintended consequences. Incentives such as subsidies for a particular green technology can lead to sub-optimal choices of technologies. For example, if solar panels are subsidised, this can lead to a



situation where it makes financial sense to install them in environments where other forms of green energy generation, e.g. wind, would be more favourable and in the long run cheaper for that particular society overall. Stringent boundaries such as environmental regulations can lead to political backlashes if they endanger traditional industries with strong lobbies or lead to structural changes with temporarily high levels of unemployment.

Cap-and-trade systems such as the European Union Emissions Trading System (EU ETS) have huge implementation problems. Moreover, intervention in market prices can lead to rent-seeking by enterprises, industries and even countries. In order to avoid such unintended effects, policies should be tested on a small scale before scaling them up in whole regions or countries. Private initiatives to introduce climate-friendly business models only work when the market







environment is conducive to them and when there is enough coordination and trust between businesses in an industry or territory.

Ideally, interventions should not specify exactly what technologies or business plans should be adopted. They should leave enough room for variety and experimentation to find novel and innovative ways to face the challenge of a green economic transformation. For example, a business should not promote wind or biogas as specific technologies to reduce the carbon footprint of a region. It should allow the local actors to try different things and select what works for them in their context. In an effective business environment, the “push” element in particular can ensure that the selected technology effectively reduces the carbon footprint of the region by setting clear boundaries. The economy will select the technology or business model that solves the problem most efficiently in given circumstances.

A well-balanced combination of all three types of instrument is needed to move in the desired direction. There is strong evidence-based support for the use of a mixture or “bundle” of instruments to encourage green behaviour in companies, governments and households. At the same time, there need to be instruments to discourage and move businesses away from less sustainable behaviours, for example the use of fossil fuels. In order to make such bundles of instruments effective, there must be awareness of how instruments and the responses they trigger interact, as there may be conflicting responses and possible systemic rebound effects. These bundles need to be created for each specific context and cannot be copied to other contexts as the context and its history strongly determine how





businesses react to different incentives. Small-scale, safe-to-fail experiments might be useful for testing the feasibility of a combination of instruments and detecting unintended consequences early on.

In an ideal situation, getting the business environment right is a process of continuous exploration and experimentation, and this takes time. Currently there is an academic and political discussion taking place on whether there is still time for exploration. 80% of the CO<sub>2</sub> is already being emitted that would allow global warming to be kept below 2°C. Following this argument, the carbon concentration has to be reduced immediately and radically to prevent ecological damage from being magnified and the costs of adaptation from exploding. This in turn would mean that there is scarcely time for testing and exploring mitigation technologies and renewable energy solutions at the territorial level. Instead, green industrial policy would need to select suitable technology families (see Altenburg et al. 2015) and use a bundle of smart interventions to (temporarily) push, pull and enable their diffusion.

In conclusion, shaping a climate-smart and eco-friendly business environment is an extraordinary challenge for both politicians and industry leaders, as it takes place in a field of political and industrial tensions and interests against a backdrop of scientific debates.

## References

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