Great Minds

Bertrand Badré

'We're on the cusp of a very positive transformation'

Bertrand Badré is a former managing director of the World Bank and the founder of Blue like an Orange Sustainable Capital, a company that invests in sustainable projects in emerging countries. We talked with him about the challenges of sustainable development, the role the private sector can play and the main ideas developed in the book he recently authored on this topic.

The main thesis of your book is that finance can serve the 'common good'. Could you explain what you mean by 'common good' and how it relates to concepts such as sustainability investing and ESG?

"For me, it boils down to the fundamentals of economics. I don't like the segregation between real economy and financial economy. We have an economy that forms a whole, in which finance is the tool par excellence for managing a number of things, including time and space."

"The problem is when finance becomes its own end; when making money with money becomes self-referential. Interestingly, the two moments in history when the share of financial activities as part of GNP reached its highest peaks were in 1929 and in 2007. So, it's clear that there are times when finance becomes its own justification. This is when we start inventing things such as CDOs-squared and other things that are not useful for funding the economy."

"The question of the common good is a difficult one. It is a fairly Western concept. I have talked with Chinese people and there is nothing equivalent in their culture. They have things such as harmony or peace. I think we can describe it as a harmonious development of our societies or what in new international jargon is known as sustainable development. In other words, a development model that respects the remuneration of not only financial capital but also human capital, social and societal capital and natural capital."

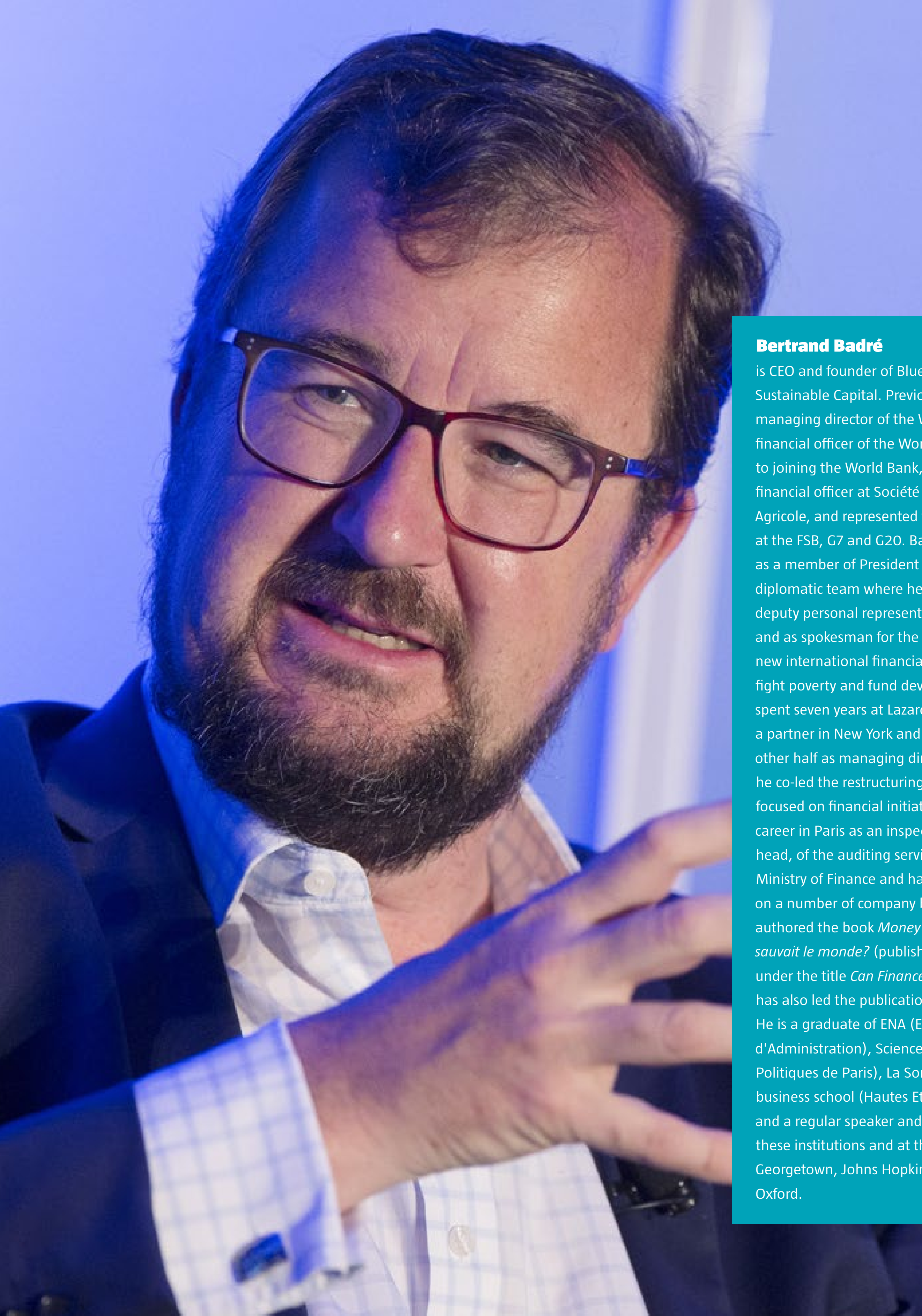
In your book, you explain that the private sector has an important role to play in this context. Nonetheless, a large part of the book is devoted to the public sector, particularly multilateral development banks (MDBs). So, what exactly can the private sector do?

"You are right. That's probably because until recently I spent several years working for these multilateral institutions. My take is that MDBs are valuable, but that we could do much more with them. We have to, in fact; and that's where the private sector should come in. Let me explain a little to give you an idea of the challenges we face."

"A few years ago, I coordinated the publication of a World Bank report[1] on the resources needed to meet the United Nations' Sustainable Development Goals (SDGs). I wanted the report to be no more than 20 pages long, to be written in accessible English and to have a catchy title: 'From Billions to Trillions'. All this may sound a bit basic, but these things don't necessarily come naturally in the world of multilateral institutions."

"More importantly, the report had to provide concrete orders of magnitude. Oftentimes, people struggle with orders of magnitude when it comes to money. As soon as an amount exceeds a few hundreds of millions, or even a billion, we tend to simply say it's a lot. We have difficulty distinguishing between 1 billion, 10 billion and 100 billion. And the global financial crisis compounded this issue. Remember the G20 summit in 2008? Some USD 5,000 billion were committed for fiscal expansion, but no one actually knew what that figure meant."

"So, what the title 'From Billions to Trillions' attempts to communicate is disparity: on the one hand we have a global economy estimated at around USD 80 trillion in nominal terms and USD 100 trillion from a purchasing-power-parity perspective,



Bertrand Badré
is CEO and founder of Blue like an Orange Sustainable Capital. Previously, he was managing director of the World Bank and chief financial officer of the World Bank Group. Prior to joining the World Bank, he was group chief financial officer at Société Générale and Crédit Agricole, and represented these institutions at the FSB, G7 and G20. Badré also served as a member of President Jacques Chirac's diplomatic team where he was the president's deputy personal representative for Africa and as spokesman for the working group on new international financial contributions to fight poverty and fund development. He also spent seven years at Lazard – half of which as a partner in New York and London, and the other half as managing director in Paris where he co-led the restructuring of Eurotunnel and focused on financial initiatives. He started his career in Paris as an inspector, then deputy head, of the auditing service of the French Ministry of Finance and has served as director on a number of company boards. Badré recently authored the book *Money Honnie, si la finance sauvait le monde?* (published in English in 2017 under the title *Can Finance Save the World?*). He has also led the publication of several articles. He is a graduate of ENA (Ecole Nationale d'Administration), SciencesPo (Institut d'Etudes Politiques de Paris), La Sorbonne and HEC business school (Hautes Etudes Commerciales), and a regular speaker and teacher at these institutions and at the universities of Georgetown, Johns Hopkins, Princeton and Oxford.

'It's obvious that money is being poorly allocated'

and the desire to put this economy on a trajectory of lower carbon consumption, and sustainable development. On the other hand, only around USD 100 billion per year by 2020 has been committed by governments as part of the COP 21 Agreement. Moreover, the combined amount managed by the IMF, the World Bank and all the big public institutions is somewhere between USD 120 and 140 billion per year, while global official development assistance is around USD 150 billion annually."

"We can see that although we have a USD 100 trillion economy, only around USD 250 or 350 billion is available to fund sustainable development. There are many estimates of what is really needed, but basically it's several trillion dollars. So there's a clear gap, hence the title. How are we bridging this gap? The answer is quite simple: basic math."

"Part of the difference will be filled by local resources, namely savings and taxes. This is also how Europe and the United States funded their development in the 19th and 20th centuries. Emerging and developing countries will have to develop sound taxation policies. I often like to mention that in 1789 France's estimated public spending rate was about 10% of the country's GDP. Today, it's 45%. This doesn't mean we should all aim for 45%, but 10% is clearly not enough. So, local public spending will be the first resource and it will be a very important one."

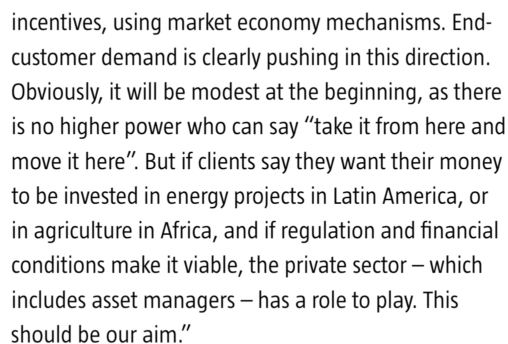
"The second resource will be private money, in other words savings. I believe that the development of physical infrastructure – roads, ports, telecom towers, etc. – and social infrastructure – schools and hospitals – requires financial infrastructure. People need to have somewhere to put their money. Even if it's just a dollar a month, you need a financial system that enables you to save so you don't have to keep your money under your mattress. Local contributions from both the public and private sectors will therefore form the lion's share of the funding for sustainable development."

"But that probably won't be enough. Some of the money may also have to come from foreign private savings. Unfortunately, this type of financial resource often does not make its way into sustainable projects in developing and emerging countries. And so my deep conviction – which I stress in my book – is that public development institutions have a role in helping private investors, to take them by the hand, as it were. MDBs need to understand that while it's important for them to fund development operations, it's probably even more important that they mobilize resources."

With this in mind, what role can asset managers play?

"To me, this question concerns one of the most important challenges we face today: how we allocate resources at a global level. We've never had so much money in savings and under third-party management. We've never had so many asset managers and so many large asset owners, including large pension funds and sovereign wealth funds. And yet, a significant part of this money is invested in debt that offers low or even negative rates of interest. It's obvious that money is being poorly allocated."

"Money needs to be allocated differently, through regulation and



incentives, using market economy mechanisms. End-customer demand is clearly pushing in this direction. Obviously, it will be modest at the beginning, as there is no higher power who can say "take it from here and move it here". But if clients say they want their money to be invested in energy projects in Latin America, or in agriculture in Africa, and if regulation and financial conditions make it viable, the private sector – which includes asset managers – has a role to play. This should be our aim."

"Clearly, the amount of money flowing into these kinds of projects will be small at the beginning. But we need to make sure that in time the trillions I spoke about in my previous answer become just that. Otherwise, the current refugee crisis may well be a mere taste of things to come. And this brings me to the blueprint I developed with Ronnie Cohen,[2] which probably sounds a bit simplistic but I think is useful."

"In the 19th century, investors focused on 'return'. So, it was OK to make steam engines that produced smoke in abundance and it was OK to dig coal mines in dreadful conditions; it was only ever about return. In the 20th century, investors started focusing more on the combination of 'risk and return', which led to the creation of things such as venture capital or private equity, which otherwise wouldn't have got through the filter of a simple 'return'. What Ronnie and I say about the 21th century is that every euro or dollar invested should take into account not only return and risk, but also impact. And it is this 'risk-return-impact' trinity that needs to be the new compass for investors. The three concepts form a whole, they are complementary."

Does this mean that all asset managers will have no other choice than to embrace sustainability investing?

"On a 20 to 30-year horizon, I think it's a given. But let's not be naïve, it won't happen overnight. People have to get used to it – they will have to test it and realize that it actually works. We'll need to develop new products and new ecosystems on a more industrial scale. We'll also need new breeds of rating agencies that specialize in assessing sustainability risks. I think this is a task for the next market cycle."

Although we're still at a very early stage, we're already seeing major disparities in the quality of what is proposed by asset managers in terms of sustainability. There seems to be a lot of enthusiasm but few rigorous approaches. What's your take on this?

"I'm not really surprised. We are on the cusp of a very positive transformation, so it is quite natural that things are a bit all over the place. We are seeing a flurry of new concepts that people don't always understand, from ESG to PRI and impact investing. At the same time, we must make sure that we don't wake up with a hangover in five years, thinking we've been brainwashed. The current commotion will have to stop at some point, regulators will need to set the tone."

So regulators will have to step in?

"Yes, of course. That's normally how things go. I am not against creativity, but this creativity should not be dishonest."

Looking back over the past decade, would you say asset management has made significant progress in terms of sustainability investing?

"I think there has been some progress. Sustainability has become a key concern. It's just an example, but I'm now asked to speak at conferences much more frequently. At the same time, a recent study said that 80 or 90% of pension funds have not yet integrated climate change into their policies. So, while we can celebrate things like the rise of green bonds, blue bonds and social impact bonds, we should also remember that this is still just a drop in the ocean."

"My hope is that we will soon pass the tipping or trigger point and move on to the next level. From that perspective, the example of green bonds is quite interesting. Green bonds were initiated by the World Bank in 2008. From 2008 to 2012/13, it became a market worth a few billion US dollars in issuance each year. And then suddenly in the run-up to COP 21 a number of major insurers made commitments, and we have now reached an annual USD 200 billion in just five years."

What do you think are the key factors that distinguish a good approach to sustainable investing from a bad one?

"I don't think we can say there is only one good approach. There are several good approaches. When is an investment sustainable? In some clear-cut cases, the obvious answer is sustainable investment and in others it's a different approach. But a very large part of all investments falls in between the two, and it is very difficult to say where you should draw the line. So, you have to be very honest and accept that you don't have all the answers, and that you will probably make mistakes at some point."

"Let me be a bit provocative and use the thermal coal example. We know that coal is bad for climate change, so the logical reaction is to stop investing in coal. This is one of the first, quite visible moves big banks and insurance companies like to make. It's a good idea but you have to push the reasoning further: is it better to have a responsible investor that remains invested in coal while encouraging the coal industry to move towards a cleaner, more responsible approach? Or, is it better to withdraw, tick the box and let less scrupulous investors do it instead?"

"I say this because the coal industry is still heavily subsidized. And if you look at energy consumption forecasts for the next 30 years, coal will continue to account for 25 or 30% year in and year out. So, there will be investments in coal, but they will simply not be made by sustainable investors. Once again, this brings us back to the global allocation problem; how to bridge the gap between individual behavior and collective goals."

Critics of sustainability investing often oppose profitability and social and environmental impact. Would you agree?

"Well, that's not an easy question. My answer is that sustainability investing requires a whole set of financial tools. Some sustainable investments simply cannot be financed by the market. A primary school in an African country is not something the market will fund, let's be honest. For this, you need public or private donations. But that's certainly not the only kind of sustainable investment you can make. There's a whole range of possibilities, from public schools to deep-water ports in exporting emerging countries. For the latter, market forces can work perfectly."

"So, you really need the whole toolbox: public or private donations, public or private concessional funding that seeks to have an impact and therefore accepts lower remuneration, and standard market compensation. And you have to be able to combine these tools, which can be complicated because it means bringing together players from very different cultures – cultures that are sometimes even suspicious of each other. You might hear things like 'You are just a ruthless capitalist!', 'You are just slow and corrupt bureaucrats!' or 'You are an NGO and you are very generous, but so naive!'"

"You need to get all of these different players talking to each other, which is possible. And if you can speak all the different languages – private-sector language, public-sector language and NGO language – you can really make a difference. But let's face it: it's difficult. It's like salad dressing: you have to shake the oil and vinegar to get the desired result. These ingredients don't naturally mix."

Investors often face the paradox of wanting to finance sustainable investment projects in emerging countries but finding themselves confronted with, for example, local governance standards that are incompatible with their ESG approach. How can this be addressed?

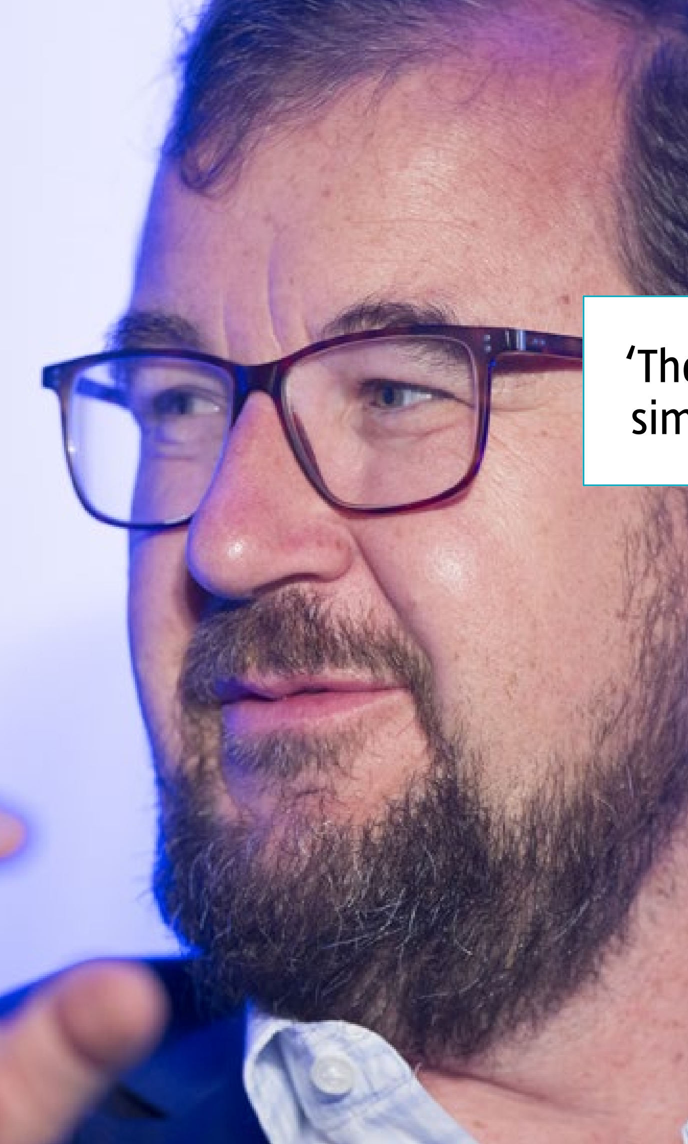
"Of course, our big developed countries are obviously so much more virtuous and have perfect governance systems and no corruption (he smiles). I think we have to be able to look at ourselves in the mirror. Some years ago, for example, Norway agreed a large public-private partnership on gas concessions. Two years later, they changed the pricing conditions and they are now being sued by half the world. Does this change the general perception of Norway? No, because Norway is rich and nice. So, we need to be modest as well. In developed countries, we are forgiven because we are rich and powerful. But if something similar happens in Senegal or in Bolivia, for example, people will say: these guys can't behave themselves."

"That being said, let's not pretend perceptions don't exist. As I often say in conferences, perception matters and it's true that many of these countries face huge challenges in relation to political stability, the rule of law or corruption. But what you have to keep in mind is that these risks also explain why investments are also typically better rewarded in emerging countries than in developed ones."

Yes, but what I mean is how can investors be consistent and finance projects in countries where those resources are needed while at the same time remaining faithful to their ethical principles?

"You are right. There is no simple answer. And that's why efforts by international and multilateral institutions are so important in helping improve the situation. The reality is that there has been some significant progress in this area. In Africa, there is more and more contrast between those countries that are emerging from the pandemonium they have been stuck in and those that are still in great difficulty."

"But let me give you a more concrete example. A few years ago, the rating agency Moody's published an excellent study[3] in which they analyzed the default and recovery rates for over 4,000



‘There are risks the financial sector simply cannot dismiss’

project finance bank loans between 1983 and 2011. One of the main conclusions was that the average years to default and ultimate recovery rates were quite similar in both OECD and non-OECD countries. This means it is possible to invest in developing and emerging countries with satisfactory conditions in terms of governance, rule of law, etc.”

Let’s say I am an asset owner wanting to embrace sustainability investing. Where should I start?

“Most so-called asset owners own their assets only by proxy. So, they should probably start by acknowledging what the ultimate asset owners – you and me – are looking for, and what matters to them. In that sense, the realization that we are in a fragile world, that from early August every year we start to overuse the Earth’s natural resources, is bound to have an impact.”

“Let me tell you an anecdote that will illustrate how important it is for governments, as well as public and private institutions to realize this. Back in 2015, we were discussing climate change at a meeting of the Financial Stability Board. There was a general lack of interest among central bankers, who did not feel at all concerned by these issues. They thought their decision-making horizon was somewhere between one and five years, certainly not the timescale needed to address climate change.”

“At the end, Mark Carney, the governor of the Bank of England and chairman of the FSB, made a memorable speech titled ‘The tragedy of the horizon’. His message was the following: a trader deals with the next second, a CFO deals with the next quarter, a CEO deals with the next year and a central banker deals with the next three years. And since addressing climate change involves making decisions on a 10-, 15- or 20-year horizon, it does not interest anyone. Well, that’s a false perception, according to Mark Carney. There are risks the financial sector simply cannot dismiss.”

“First, there’s the physical risk. There is little doubt that the recent increase in the frequency, intensity and cost of natural disasters can be attributed at least in part to climate change. So, for insurers and reinsurers, it's already a problem today, not in 20 or 30 years. If an insurer or reinsurer is hit by a huge natural disaster, this has an impact on the system. Second, there’s liability risk. You let me build a house by the sea in 2017, while COP 21 said that the sea level was rising. You knew this but still you let me do it, so now I'm suing you.”

“Third, there’s transition risk. If we are serious about limiting global warming to 2 degrees Celsius, we know we won’t be able to burn all of the existing fossil fuel reserves. So, we also know that a significant part of the reserves on many companies’ balance sheets are actually worth nothing. And I am not talking about millions of US dollars here; I am talking about trillions. How do we address this? You see, even if climate change may seem like a very distant threat, in reality it is already upon us.”

[1] ‘From Billions to Trillions: Transforming Development Finance’, report prepared jointly by the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank, the International Monetary Fund, and the World Bank Group for the 18 April 2015 Development Committee meeting.
[2] Sir Ronald Cohen is an Egyptian-born British businessman and political figure. He is one of the founding fathers of British venture capital and a pioneer of impact investing.
[3] See: ‘Default and Recovery Rates for Project Finance Bank Loans, 1983–2011’, Moody’s Special Comment, February 2013.