

Earth Day 50

Sustainable finance: the road ahead

Keynote speech to Earth Day Week

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About this paper

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This policy paper is intended to inform decision-makers in the public, private and third sectors. The views expressed in this paper represent those of the author and do not necessarily represent those of the host institutions or funders.

Making the financial system sustainable

It is truly humbling to join you today as part of Earth Day 50¹ to identify how we can make the world's financial system a tool for achieving climate security and sustainable development.

The Coronavirus crisis continues to take lives across the world. Over 150,000 people have perished, bringing profound sorrow to millions. It is driving economic dislocation in terms of job loss and hunger and will impact billions of people on a scale not seen since the Great Depression of the 1930s.

Behind this acute human emergency lies those chronic emergencies of global poverty, rising inequality, species extinction, urban air pollution, water scarcity and, of course, climate change.

And we know that these crises are interlinked: that deforestation, illegal wildlife trade, intensive agriculture and climate change are all driving an increasing emergence of zoonotic diseases such as Covid-19: 75 per cent of all emerging infectious diseases are zoonotic, in other words come to humans from animals (UNEP, 2020).

Finance is involved in all these emergencies – both in terms of causation and in terms of solution.

The \$379 trillion question

At the last count, we have \$379 trillion in assets across the financial system in banks and central banks, pension funds and insurance firms, stock markets and bond markets and the nest-eggs of citizen savers in all parts of the globe (Financial Stability Board, 2020): \$379 trillion dollars – more than enough to deliver a rapid transition to a resilient, just and zero emissions economy by the middle of this century.

The problem is that the rules of the game and the market incentives, the conventional wisdoms and daily routines, make it easier and more profitable for these trillions to bet against the planet and ignore human development.

The International Monetary Fund, for example, estimates that we're making an annual \$5 trillion dollar bet against the climate by providing subsidies for fossil fuels and failing to price the damage caused by carbon pollution (Coady et al., 2019).

This results in gross over-investment in high-carbon industries and lifestyles – all storing up stranded assets and systemic disruption. And it results in gross under-investment in clean technologies and social enterprise – all structural missed opportunities for long-term returns and positive impact.

Let's be clear on the scale of the financial mismatch. On one hand, we are making a perverse bet of well over 5 per cent of global gross domestic product in supporting fossil fuels and carbon pollution. On the other hand, the investment required to save the climate has been estimated at around 1 per cent of gross domestic product.

This has never been an issue of a lack of money or finance, but about the rules that govern the allocation of that capital. We know we have the finance to deliver the transition to sustainable development. Whether we achieve this is up to us.

But all is not lost. A movement is sweeping across the world's financial system. That movement is sustainable finance.

¹ See <https://www.wedonthavetime.org/event/earthdayweek>

Taking stock of sustainable finance 50 years on

At the time of the first Earth Day on 22 April 1970, the idea that finance should be harnessed to achieve environmental and social progress was far from people's minds. But even then, things were starting to move. The first socially responsible investment fund, the Pax World Fund, was set up by two Methodist Ministers in the USA, Luther Tyson and Jack Corbett, the following August.

Now, 50 years on, never before has so much finance been committed to sustainable and responsible practices:

- **Investors:** We have over \$80 trillion dollars of investor assets committing to integrate ESG – environmental, social and governance factors – into their decisions through the Principles for Responsible Investment.²
- **Banks:** We have more than \$47 trillion dollars of banking assets committed through the Principles for Responsible Banking to contribute to individuals' needs and society's goals, as expressed in the Sustainable Development Goals and the Paris Agreement on climate change.³
- **Development banks:** We have national and multilateral development banks working to move the financial frontier. Eleven multilateral development banks have pledged to raise annual climate finance to \$175 billion dollars by 2025 (Bennett, 2019). Twenty-six national development banks have committed to align their portfolios with the Paris Agreement (IDFC Climate Finance Working Group, 2018).
- **Central banks and regulators:** Launched by France in 2017, we have 65 central banks and financial regulators from developed and developing countries committing to take action on climate risk through the Network for Greening the Financial System (NGFS, 2020).
- **Finance ministers:** Sustainable finance has also become a priority for the world's finance ministers. It was China that first put green finance on the agenda of the G20 and the EU is now leading the charge with its Sustainable Finance Action Plan.

So, we have no lack of awareness or commitment. What we need now is the acceleration and deepening of action to deliver the transformation in financial practices we need to see.

Resetting sustainable finance for the decade ahead

We are in the midst of the Coronavirus crisis. This requires urgent action from all parts of the financial system, not just in the immediate health and economic emergency, but in the recovery that follows.

We have a lot to build upon – but a long way still to go. So how should we reset sustainable finance in the decade to 2030, when carbon emissions will need to be halved and the Sustainable Development Goals implemented in full?

I would suggest five priorities for the road ahead:

- **First, finance needs to be *green*.** Today, we have increasing focus on climate disclosure, a necessary step forward.⁴ More importantly, however, we also have pioneering investors committed to making their portfolios consistent with keeping global temperature rise to 1.5°C by 2050.⁵ By 2030, all financial institutions and regulators will need to be taking action to achieve alignment with net zero. And the \$5 trillion bet will have to be eliminated through carbon pricing with the revenues raised returned on a per capita basis to ensure fairness.
- **Second, finance needs to be *just*.** To date, the 'S' or 'social' dimension of ESG has too often been silent, with human rights viewed as a risk rather than as an imperative to be respected. The need

² See <https://www.unepfi.org/net-zero-alliance/>

³ See <https://www.unepfi.org/banking/bankingprinciples/>

⁴ See <https://www.fsb-tcfd.org/>

⁵ See <https://www.unepfi.org/net-zero-alliance/>

for finance to support a just transition is now acknowledged (Robins et al., 2018). By 2030, all financial institutions and regulators will need to show how they are delivering positive social impact, eliminating poverty and reducing inequality.

- **Third, finance needs to be *resilient*.** The current crisis has revealed once more just how fragile we are in the face of shocks. And these shocks are set to increase from climate change and degraded natural resources. This is not just a task for the insurance sector. By 2030, all financial institutions and regulators will need to have strategies for resilience, ensuring that they help both users and vulnerable communities to bounce back.
- **Fourth, finance needs to be *rooted*.** Over the past 50 years, finance has become global. This has brought benefits. But finance is increasingly seen as a system apart, with benefits flowing to metropolitan finance hubs, to Wall Street not Main Street. By 2030, all finance institutions and regulators will need to demonstrate how they are responding to place-based needs, including via new instruments and institutions rooted in local realities.⁶
- **And fifth, finance needs to be *responsive*.** Many are missing out on even the most basic products: about a third of people are still without a bank account (World Bank, 2018). Kenya has shown the world how political will and digital technology can combine to deliver financial inclusion. So, by 2030, all financial institutions and regulators will need to be responsive to over 8 billion individuals and many more institutions, notably the small businesses that prop up the global economy. This includes providing the financial products that meet people's aspirations for a better world.

Financing a sustainable and inclusive recovery

I would now like to turn to the immediate task at hand – deploying the assets and expertise of the global financial system to drive a sustainable and inclusive recovery out of the Coronavirus crisis.

In the words of UN Secretary General Antonio Guterres, we have the strategic responsibility to “recover better” (Guterres, 2020). In the wake of the global financial crisis, I and colleagues at HSBC estimated that governments introduced ‘green stimulus’ programmes amounting to just over 16 per cent of the total public finance boost (International Labour Organization and International Institute for Labour Studies, 2011).

Governments must now take a far more comprehensive view so that 100 per cent of their Covid-19 recovery plans are aligned with the Paris Agreement, with a special focus on the needs of the most vulnerable to deliver a just transition.

What does this mean in practice?

- **First, recovery plans must be designed and delivered to be consistent with the Paris Agreement.** Any support for high-carbon sectors must be contingent on measurable net-zero emissions plans, with programmes for involving workers and communities in their design and delivery.
- **Second, a sizeable proportion of recovery spending, considerably above the levels seen in 2009–2010, should be directed to sustainable growth.** A wealth of options exists, including renewable energy and energy storage, making buildings more efficient, public transport, as well as land use, climate adaptation and nature-based solutions. Many of these are cheaper and more ‘shovel-ready’ than a decade ago.
- **Third, the recovery packages should promote a coordinated multilateral response through the UN and the G20.** Special attention should be given to the needs of developing economies, where coronavirus impacts are set to be most severe and capital for the transition is in shortest supply. A portion of the recovery funds in industrialised countries must therefore be dedicated to support the transition efforts of developing countries. In this way, we could meet and exceed the longstanding pledge for \$100 billion in annual North–South flows in climate finance. And we could

⁶ See, for example, the work of Abundance: <https://issuers.abundanceinvestment.com/local-authorities>

make COP26 in 2021 the place where sustainable recovery plans are shared, upgraded and coordinated.

These recovery plans will be financed in many ways. One route is through increased government borrowing in the form of sovereign bonds. So far, around \$60 billion of green sovereign bonds have been issued from 12 countries and a further 10 nations have indicated that they will issue green sovereign bonds this year (Climate Bonds, 2020).

A coordinated issuance of green, social and sustainable sovereign bonds in the hundreds of billions of dollars by governments over the coming year would be both a practical mechanism for paying for a sustainable recovery and a powerful signal to the market.

Alongside this, central banks will need to ensure that climate risks are incorporated into monetary operations to avoid unintended climate consequences.

Be bold, be open, experiment, take action

As we think about the action we need to take today, we can draw inspiration from those who faced similar challenges in the past.

One of these was John Maynard Keynes, the great economist (and investor), who guided the world out of the Great Depression of the last century. He wrote this in 1929:

“There is no reason why we should not feel ourselves to be free to be bold, to be open, to experiment, to take action, to try the possibility of things.”

So let us be bold, be open, experiment, take action, try the possibility of things so that sustainable finance becomes the norm – so that by Earth Day 60 in 2030, finance has helped to build a regenerated Earth.

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