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TOWARD A SUSTAINABLE, RESILIENT FINANCIAL SYSTEM PRIORITIES FOR THE G7 IN 2022

FRANKLIN STEVES

For the third year in a row, the world faces major destabilising crises whose impacts are compounded by the climate emergency. These crises are creating fragilities in the global financial system for both G7 countries and developing and emerging economies. Strengthening the resilience and preparedness of the financial system to deal with transitory and physical risks from climate change will be key to ensuring financial and economic stability. The G7 will need to show leadership in driving continued international collaboration on standards.

Background

The G7's financial and economic exposure to the market-shaping power of Russian fossil fuels underscores that a rapid transition toward cleaner alternatives is vital. Beyond the energy security risk, the current dependency on Russian energy poses significant risks to environmental, economic, geopolitical, and financial stability.

G7 countries and their allies have applied wide-reaching financial sanctions in response to the Russian invasion of Ukraine. The combined impacts of the war and the sanctions have created a severe economic shock for developing and emerging economies, which were already struggling to recover from the economic impacts of COVID-19 and post-Covid inflationary pressures.

In 2021, the G7 emphasised “the need to green the global financial system so that financial decisions take climate considerations into account” and played an important role in the adoption of the G20 Sustainable Finance Roadmap. In 2022, G7 countries have demonstrated an ability to make urgent and transformative



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changes to the financial system in response to Russia’s aggression – and a willingness to use the financial system as a lever to pursue geopolitical objectives.

However, there is a risk that coordinated G7 action in the financial sphere, designed to halt Russian aggression, leads to fragmentation of the global financial and trade architecture – and generates opposition to international cooperation, which could in turn undermine efforts to accelerate financing of the net zero transition.

The G7 now has an opportunity to support rapid financial system reforms for climate transition and sustainability. These reforms will both increase resilience and security at home and support recovery and stability in the rest of the world. In a year when the ability of the G20 to act in a unified way is in doubt, the leadership of the G7 – and genuine engagement with EMDEs – is crucial.

Priority Actions for the G7

The German G7 presidency has outlined **sustainable finance priorities** to “ensure economic and financial stability and resilience against future crises, and shape the transformation processes in the context of digitalisation and climate neutrality.”

Building on these priorities, and previous progress made by the G7 in 2021, the following four policy solutions should be pursued by G7 finance ministers and central banks this year:

1. Accelerate the clean energy transition by committing to rapid phase-outs of subsidies and investments relating to fossil fuels

The Russian invasion of Ukraine is demonstrating daily the need to transition the world away from fossil fuels. To tackle dependence on fossil fuel imports, the G7 should agree to scale investment into renewable energy solutions and energy efficiency – building the financial architecture for net zero transition and ensuring that public banks, including Central Banks and International Financial Institutions support the decarbonisation agenda – and commit to giving such investments the same priority as defence spending commitments of 2% of GDP.

Building on previous international commitments, such as the *Glasgow International Support to Clean Energy Transition* declaration, G7 countries should establish a common path to phase out fossil fuel subsidies and end international public investment in fossil fuels, starting with a phase out of fossil finance at all G7-owned MDBs. In particular, 2022 should be the year in which the G7 announces measures to disincentivise private sector investment in coal.



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2. Commit to narrowing the trillion-dollar sustainable infrastructure investment gap

The world is looking to the G7 to mobilise sustainable finance at scale to developing and emerging economies – and provide an alternative to China’s Belt and Road Initiative. Private finance has made ambitious pledges, including through the launch of the Glasgow Finance Alliance for Net Zero (GFANZ) at COP26. But investment opportunities will not materialise without coordination and concrete risk-mitigation tools offered by the public sector and development banks.

G7 finance ministers should commit to narrowing the gap and leveraging private finance at scale, making increased use of de-risking tools, including guarantees and creating a framework for the pooling of the resources of development finance institutions. GFANZ can be a partner and supporter in these efforts.

3. Outline specific next steps towards establishing net-zero financial systems and supporting international convergence

The statement of support for net zero financial systems made by the G7 in 2021 should now be followed by an indication of specific next steps to be taken towards this goal. Next steps should include the development of private sector climate transition plans, sustainability disclosure requirements, and interoperable taxonomies of sustainable and unsustainable investments across jurisdictions.

Furthermore, the G7 should commit to adopting the recommendations of international standards setting bodies to establish an international alignment, convergence and equivalency regime for key climate-related financial regulations. G7 leadership supporting the creation of common standards in international forums will help to shore up the rules-based multilateral order while also facilitating the efficient flow of private and public capital to net zero purposes.

4. Commit to implementing reforms which will reduce climate-related financial instability

Climate change presents substantial risks to a financial system which is already under intense pressure. G7 countries should jointly establish science-based principles for assessing risks to the stability of the financial system, mandate their central banks to carry out regular macrofinancial stress tests, and commit to implementing the recommendations of the Basel Committee on greening macroprudential regulation. Across all of these fields, the precautionary principle



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should form the basis of macroprudential regulation, rather than a market-based approach.

Conclusion

The G7 countries must show leadership, and must ensure that their economic and financial systems are adequately prepared for the imminent risks of a rapid transition from fossil fuel dependency toward a cleaner, climate neutral future.

This leadership is badly needed not only by citizens of G7 countries but also by the citizens of developing and emerging economies which have been badly impacted by recent events.

Without strong G7 leadership, particularly around international standards, there is a risk that the global financial system could become fragmented in light of geopolitical tensions. Strengthening rules-based multilateralism and collaboration will benefit both G7 countries, and the world.



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About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

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