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FINANCE AND CLIMATE: PRIORITIES FOR THE 2021 UK G7 PRESIDENCY

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In 2021, through its G7 Presidency, the United Kingdom can be one of the countries that leads the world's response to a set of converging crises for the international community, including (but not limited to) crises of human health, economic development, and climate change.

The G7 must make progress in averting crises of financing for sustainable recovery around the world, while also ensuring that recovery is sustainable and advancing financial system reforms that will build future resilience. Meeting these challenges will require synchronised reform to macroeconomic management, financial policy and financial institutions.

Overview

This briefing, prepared by E3G, identifies three key priorities for the UK's G7 Presidency in terms of finance actions that support economic sustainability:

1. **Key steps for greening the recovery**
2. **Advancing financial system reform for sustainability**
3. **International cooperation on finance to address immediate and long-term sustainable development needs**

Key steps for greening the recovery

Global economic recovery measures create **a time-limited window to set trajectories that can achieve net zero greenhouse gas emissions by mid-century.** As the IMF's Managing Director Kristalina Georgieva has warned the Italian G20 Presidency, 2021 will be "a year to revive or lose the Paris

Agreement"[1]. There is considerable risk of locking in emissions for decades to come through economic relief and stimulus measures which support emissions-intensive industries and infrastructure. Recent studies have borne out this concern, showing that approximately 54% of total G20 stimulus support in the energy sector has been directed towards fossil fuels.[2]

As countries look to green their future efforts, there is an opportunity to build on momentum to **green public finances**. In addition, the issue of 'defining green' for public and private investments is becoming a sticking point and there is a clear need for **multilateral cooperation on setting norms for sustainable finance**.

We recommend:

i. **Ensuring recovery responses are green.** In the Leaders' Communique, the G7 countries should generally commit to greening their recovery spending. G7 countries should create an independent transparency mechanism (e.g. involving peer assessment, legislators, or the OECD) for monitoring this commitment and reviewing progress (e.g. every 4-6 months). Fleshing this commitment out through defining specific benchmarks (see below on taxonomies) should be a priority for G7 Finance Ministers, who should champion this issue in the G20 Finance Ministers track. G7 Finance Ministers Communique should commit to screening and implementing recovery plans to be respectful of the Do No Significant Harm principle—and should agree to a common minimum floor for public expenditure to be directed towards climate-safe and resilience-supportive activities. UK collaboration with Italy on this issue will be key to ensuring G20 action.

ii. **Clearly signalling to markets that unsustainable economic activities are poor investment prospects.** As part of this collaborative effort, members of the G7 should indicate support for achieving international consensus on guiding investments in support of net-zero, e.g. via the 'common ground' taxonomy process currently being led by China within the International Platform on Sustainable Finance. The UK should also lead the G7 to follow its commitment to definitively exclude fossil fuel investments from export finance and other overseas public financing. In the context of wider fossil fuel subsidy reform, the G7 can commit to present a roadmap by the first G7 Finance Ministers

[1] Remarks by IMF Managing Director Kristalina Georgieva to Italy's National Consultation , June 2020, **https://www.imf.org/en/News/Articles/2020/06/13/sp061320-Italy-Europe-and-the-Global-Recovery-in-2021**

[2] Climate Transparency Report 2020, **https://www.climate-transparency.org/wp-content/uploads/2020/11/Climate-Transparency-Report-2020.pdf**

meeting in 2022, on how they will achieve their phaseout of fossil fuel subsidies by 2025 or earlier.

iii. **Greening public finances**: More broadly, the UK has announced/taken leading actions to green public finances, including adjusting Green Book rules, assessing the costs of the net-zero transition, and evaluating the impact of climate change on fiscal risks. In 2021 there is a unique opportunity for the UK – potentially working with France – to take further leadership and build a Green Public Finances Alliance with other G7 members which have undertaken green budgets, climate mainstreaming, etc, leveraging this group of champions to encourage action at the G20 and through the Coalition of Finance Ministers for Climate Action. These discussions should start at the G7 Finance Deputies meeting in January and continue through the year.

Advancing financial system reform for sustainability

The G7 Presidency provides the UK with an opportunity to **progress climate-related financial reforms for economic prosperity, improved risk management, and a sustainable financial system**. The UK can mainstream its own leadership in setting new international financial norms, notably for supervisory stress-testing, climate risk disclosure and management, greening public finances, and national planning for financing the climate transition as part of green recovery:

> **Supervisory stress-testing:** Following actions already pledged by the Bank of England, Banque de France and the European Central Bank, G7 central bank governors should commit (by 2023) to stress-test financial institutions' resilience to climate-related risks and commit to share best practices. They should take this issue to G20 Finance Ministers, with a view to mandating the Financial Stability Board on this issue.

> **Greening monetary policy:** G7 Finance Ministers and Central Bank Governors should also commit to adequate integration of climate change considerations into monetary policy operations (e.g. integrating climate risks into asset purchase programs, provision of liquidity to the banking sector, own portfolio management, by 2022/3).

> **Climate risk disclosure and management**: Following the example of the UK's TCFD Roadmap, G7 leaders should commit to mandating TCFD-aligned climate risk disclosure by all major public and private companies including financial firms (e.g. by 2025). The information to be disclosed should include 'comprehensive and credible' organisational transition plans as described in Mark Carney's COP26

Private Sector Strategy[3]. G7 governments could also commit to work together to set clear and consistent market expectations for 'comprehensive and credible' plans. These discussions should start at the Q1 Finance Ministers meeting and be clearly signalled to markets through the year.

> **National planning for financing the climate transition as part of green recovery**: The UK is in the process of assessing the costs of meeting net-zero and will publish a Net Zero Strategy in 2021 that includes a plan for financing these needs. Following the UK's example, G7 countries should commit to assessing the costs and financing pathways for meeting their commitments under the Paris Agreement. Clear policy signals on national financing plans are increasingly expected by private investors who are seeking to invest in the transition; aggregation of such across countries can permit capital markets to play a greater role in financing the climate transition. Making national financing plans a norm ahead of COP26 will also support countries to provide good quality Nationally Determined Contributions in the revision cycle. The UK could also build on its moves to create a new National Infrastructure Bank with a net-zero mandate, by working with other G7 countries to initiate exchanges and cooperation between new and reformed public banks on supporting climate transitions.

International cooperation on finance to address immediate and long-term sustainable development needs

Lastly, but of largest significance to the broader international community, G7 countries should commit to **enhanced international cooperation on financing a sustainable recovery worldwide**, building greater resilience to future shocks. Limited fiscal space is rendering an increasing number of developing countries unable to both service debts and pay for essential services such as healthcare, also restricting their ability to invest in long-term economic recovery or climate action.[4] With some countries already teetering on the brink of insolvency, this is the worst economic crisis for developing countries in many decades.

Experts agree that timely international action on finance and debt is required to minimize economic scarring and loss of poverty reduction gains, which imperil delivery of the 2030 Sustainable Development Goals. The World Bank warns that the absence of timely action could result in "unfolding

[3] Building a Private Finance System for Net Zero, November 2020, **https://ukcop26.org/wp-content/uploads/2020/11/COP26-Private-Finance-Hub-Strategy_Nov-2020v4.1.pdf**

[4] Building Forward Together: Financing a Sustainable Recovery for the Future of All, November 2020, United Nations Economic Commission for Africa, **https://www.uneca.org/sites/default/files/PublicationFiles/building_forward_together.pdf**

socioeconomic catastrophe that poses huge cross-border risks, including for future contagions, social tensions and unrest, and new waves of displacement and migration”.[5]

Provision of a timely counter-cyclical international investment response is also imperative in economic terms to avoid prolonged global recession. As developing countries represent roughly half of world economic output, their ability as markets to recover quickly will have repercussions on developed country economies and global recovery prospects. As developing countries represent much of global emissions, their capacity to invest in low-carbon infrastructure is also key to action this decade to deliver the Paris Agreement.

The World Bank estimates that external financing needs may increase by up to $600bn for IBRD countries and up to $100bn for IDA countries.[6] The G7 governments, as the world’s largest donors, shareholders of the IFIs, and public creditors, must make early progress on this agenda, particularly in the context of the $100bn climate finance commitment. **Under the framework of delivering a concerted international investment drive for sustainable recovery worldwide, the UK can lead the G7 in taking forward the following actions and build momentum for the G20:**

> **IMF issuance of Special Drawing Rights** – reactivating proposals for issuance of Special Drawing Rights, aiming for SDR 1 trillion, although SDR 500 billion was previously considered a limit with the Republican Party controlling the US Senate (SDRs are based on a basket of currencies, so the 500bn equates to roughly USD 700bn). This should be reallocated to ensure developing economies receive SDRs based on need rather than quota – at present allocation is skewed to benefit developed economies. UK G7 diplomacy with the Biden administration could agreement on this happen by the Spring Meetings.

> **Debt relief and reform** – extending the Debt Service Suspension Initiative until 2022 (a decision on this could be made by April); and updating the Debt Sustainability Analysis issued by the IMF-WB to ensure that it enables rather than prohibits investment, whilst at the same time discouraging investment in stranded assets. This will be vital to delivering future economic growth, and so appointing the IMF-WB to investigate this should be a high priority, given that DSAs are at the

[5] Leaning Forward to Save Lives, Scale-up Impact and Get Back on Track: World Bank Group COVID-19 Crisis Response Update, Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries, October 2020, **https://devcommittee.org/sites/dc/files/download/Documents/2020-10/Final_DC2020-0006%20COVID%2019%20P.pdf**

[6] Leaning Forward to Save Lives, Scale-up Impact and Get Back on Track: World Bank Group COVID-19 Crisis Response Update, Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries, October 2020, **https://devcommittee.org/sites/dc/files/download/Documents/2020-10/Final_DC2020-0006%20COVID%2019%20P.pdf**

heart of the G20 Common Debt Framework. The goal should be to improve approaches on debt sustainability to enable investments in resilience or sustainable infrastructure (e.g. energy efficiency, storage) which deliver savings, for enhanced macroeconomic and fiscal performance.

> **Country debt/investment packages for accelerated transition** – Advancing the SDG/climate-linked debt swaps agenda, working with coal-intensive countries whose public finances are vulnerable, to support a faster transition through a combination of debt relief and new investment, could be a success story for COP26. This requires political engagement notably in countries such as South Africa and Indonesia. Positive Paris Agreement/SDG conditionalities that deliver just transition and social outcomes can assure public support – and a general high-level frame for these country-specific partnerships should be agreed with developing countries at an ad hoc summit early in the first half of 2021, such as the UK's planned March summit.

> **Reform and expansion of MDB/DFI financing capabilities** – conditional on MDB/DFI reform to achieve timely/meaningful Paris alignment as well as enhanced climate action targets, shareholders can increase capitalisation of MDB/DFIs to achieve large multipliers[7]; shareholders can also use off-balance-sheet mechanisms to expand institutional financing capabilities. Approaches could include using callable capital in capital adequacy calculations[8], other contingent liabilities[9], and better use of balance sheets within and beyond existing credit ratings[10].

Mapping these against the 2021 diplomatic calendar, the UK can work with partners to progress these at ad hoc summits in Q1/Q2 and at WB/IMF Spring Meetings, toward outcomes at the UK G7, which can then be taken for further resolution at the WB/IMF Annual Meetings and the Italian G20, and beyond.

Affirming the UK's standing as a world-leading financial centre, the G7 should work with the G20 to package the above efforts into an international investment drive for global sustainable recovery, with a focus on sustainable infrastructure. The UK will find strong allies in this investment agenda in Italy, the UN and multilateral system, as well as the private sector. As IMF MD

[7] Beyond the Numbers: Why the World Needs a More Ambitious MDB Response to COVID-19, Center for Global Development, November 2020, **https://www.cgdev.org/blog/beyond-numbers-why-world-needs-more-ambitious-mdb-response-covid-19?utm_source=201117&utm_medium=cgd_email&utm_campaign=cgd_weekly**

[8] All hands on deck: how to scale up multilateral financing to face the Covid-19 crisis, Overseas Development Institute, April 2020, **https://www.odi.org/publications/16832-all-hands-deck-how-scale-multilateral-financing-face-coronavirus-crisis**

[9] Six proposals to strengthen the finances of multilateral development banks, Overseas Development Institute, April 2020, **https://www.odi.org/sites/odi.org.uk/files/resource-documents/11451.pdf**

[10] See 4, from UNECA.

Kristalina Georgieva noted to the G20, "[it] is… time to prepare a synchronized green and digital infrastructure investment push to invigorate growth, to limit scarring, and address climate goals. If G20 countries act together, they can achieve two-thirds more at the same cost than if each country acts alone."[11]

If strong climate conditions and incentives/earmarks are attached, an ambitious international investment drive, which aims at unlocking hundreds of billions (USD) in new financing for a truly global recovery, would also help solve the political challenge of delivering the Paris Agreement commitment to mobilise the $100bn in climate finance annually by 2020. To achieve this, concessional climate finance for both middle-income and lower-income countries will be key. Demonstrating confidence in meeting this COP commitment, and in high-level engagement on the post-2025 goal, will be key to the success of COP26.

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[11] IMF Managing Director Kristalina Georgieva Urges G20 Leaders to Jointly Build the Foundations of a Better 21st Century Global Economy, November 2020, **https://www.imf.org/en/News/Articles/2020/11/22/pr20353-imf-managing-director-kristalina-georgieva-urges-g20-leaders-build-better-global-economy**