47. Introduction to Part VI

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In recent decades, the finance sector has become divorced from the real economy. Finance has become a dominant sector in and of itself, rather than playing its 'notional' role of intermediation between savers and investors, or its role in risk management for insurance, pensions and so on. This separation of finance from 'real investment' fosters asset bubbles and emboldens a focus on short-termism. Short-termism in turn places pressure on investors or corporations to act without due consideration for the impacts of their operations on the environment or wider society, particularly over the longer term. It also diminishes willingness to take risks through the kinds of innovation or investment that may have longer-term pay-offs.

Climate change, along with increasing water scarcity, destructuration of fertile soils and biodiversity collapse, pose major threats to financial stability because of potential consequences for economies, firms and financial institutions. These risks arise in three ways: physical losses due both to extreme weather events and to adverse impacts of gradual climate change; transition risks due to changes in climate policies, technology and consumer and investor preferences that reprice assets; and legal risks related to fiduciary responsibilities. Financial losses from climate events have risen sharply in recent years.

The nature of climate change means we cannot disregard or downplay the long-term impacts. And, whilst action across the whole world economy is urgent, we cannot focus only on short-term responses. We need all tools, resources and ideas, implemented over many decades, to tackle the intense climate challenge and manage the rapid and radical transition to a zero-carbon world. Policy-makers must recognize the urgency and scale of the challenge and work decisively to bring the finance sector back towards the real economy through providing clear, credible and long-term strategies and policies.

Supporting and managing the transition will require significant investment and strong innovation. Infrastructure investment will involve a doubling of the existing stock over the next 15 years or so. Much of this investment will have to happen one way or another, but to meet the climate change objectives and the Sustainable Development Goals (SDGs), all of it has to be sustainable from now on. How this infrastructure and other capital investment happens will be a key determinant of our ability to manage or avoid the extreme risks

of climate change. Following the growth and infrastructure models of the past and locking in high-carbon and polluting investments would put us in great danger. On the other hand, we can set off on a new and very attractive direction for growth and development, including cities where we can move and breathe and ecosystems that are robust and fruitful.

The potential economic and social benefits of these investments in the short, medium and long term are immense. In the shorter term, since the world economy is demand constrained, with very low interest rates, the extra investments would both boost demand and sharpen supply. Investment in sustainable infrastructure and human capital can foster great advances in health and well-being across the world. In the medium term, this investment would unleash waves of innovation and discovery. In the long term, investment would protect lives and livelihoods by avoiding the worst impacts of climate change; there is no long-run feasible high-carbon growth story – it self-destructs. Growth, poverty reduction, and strong action on climate change are, therefore, complementary, interwoven and very attractive. We must not pretend that the transition will be easy: the necessary change must be rapid and radical. But it can be managed so that there are opportunities for all, and the prize is immense.

Unleashing this new form of growth, however, requires widespread structural changes to many systems across the whole economy and across the world. The financial system will be a fundamental and early driver. It must now change so that all its investments are sustainable and Paris aligned.

This part of the book draws attention to many of the positive signals we are already receiving from the financial sector; the movement has started and is gathering momentum. Jeremy Oppenheim and Catharina Dyvik highlight examples of real innovation and leadership in sustainable finance, showing important cases and examples in regulation, fiduciary duty, infrastructure and new technology, new products, data and tools, and transparency. Considering the Chinese context, Ma Jun describes the rapid proliferation of innovative green financial products, and praises the positive, proactive role that the Chinese government and regulators have played in designing and developing a thriving green financial system.

Despite the range of promising initiatives highlighted, including the Task Force on Climate-related Financial Disclosures (TCFD), the Network for Greening the Financial System (NGFS), the Green Bond Pledge, the Transition Pathway Initiative (TPI), the World Benchmarking Alliance, and ShareAction's asset owners disclosure project, we cannot yet claim that movement embodies the pace that is necessary. Given that time is absolutely of the essence, Oppenheim and Dyvik emphasize their unease that the actions they describe are not happening at the necessary scale, speed or ambition required. If done well, strategic action would enable us to get ahead of possible market

disruption and embrace the opportunities presented by climate action. Delay or inaction, on the other hand, leaves us vulnerable to fast-worsening outcomes. Further, on the critical aspect of investment and disinvestment decisions, Alain Grandjean questions whether the current ‘greening’ of the financial system extends beyond the rhetoric to tangible choices being made by financial investors.

Whilst being realistic on current actions and intentions, we cannot afford to be negative and dismissive. Ma Jun echoes the sentiment that still stronger measures to further promote green finance are required. In response, he proposes actions that China could implement to take on this challenge. Many of the recommendations would create precedent for interventions that can be replicated in other economies: greening institutional investors; mainstreaming environmental risk analysis; and harmonizing green finance standards, are examples. Additionally, a series of interventions that can be made by public authorities to accelerate the effective consideration of climate issues in investment decisions are proposed by Grandjean: banning public banks from financing fossil fuels; greening monetary policy; and penalizing banks that finance the fossil fuel economy. Furthermore, the story, presented by Stephen Heintz, of how the Rockefeller Brothers Fund came to their decision to join 800 other individual and institutional investors, in the Divest-Invest movement, shows how much the landscape is evolving. The combination of the Fund’s commitment to fully divest from fossil fuel exposure, along with an impact investment target, which was increased from 10 to 20 percent in 2016, embodies both sides of the new growth story.

It is, of course, not enough for the financial system to simply cease financing unsustainable investments; it must be transformed to mobilize the trillions that will be needed for sustainable investments and climate resilience. This will require unlocking a number of finance pools to work together: domestic public resources; international public finance; and private finance. Here, the role of national and multilateral development banks will be crucial, providing risk management and reduction, and precious patient capital at a time of mounting uncertainty. It will be vital for these institutions to better use their balance sheets and access to concessional finance to build the pipelines of assets where private actors fear to tread. The presence of a multilateral development bank or a national finance institution in a project or transaction itself reduces risks of unreliable government policies and actions. They can bring equity, guarantees and long-term loans. Further, creating the power of the example is key, particularly in developing and emerging markets, and they can back innovation and creativity.

Since it is the aggregate emissions that are fundamental, it is important for all the major countries and regions to be on board. International collaboration could greatly enhance the work of different types of financial institution.

Change is urgent everywhere, but in the context of income, technology, innovations and history, rich countries have an obligation to support and share technologies with their developing counterparts. It's important to continue to drive down costs across the board, as we have already seen in solar and wind energy, storage of electricity, LED light bulbs and so on. Collaboration can bring the necessary scale and confidence in future markets.

The rich countries must also play a strong role in driving down the cost of capital by helping with the policies and institutions that can bring through the right investment, and by helping advance the multilateral development banks (MDB), development finance institutions (DFI) and bilateral support for the right kind of finance, at the right scale, at the right time.

A positive feedback loop between international climate agreements and the confidence necessary for sustainable investment and innovation points to the critical moment presented by the 26th session of the Conference of the Parties to the United Nations Framework Convention on Climate Change (UNFCCC COP26) in 2021 and the actions that should follow.

We must emphasize again that seizing the opportunity requires radical and rapid change. Most of what we currently do will have to be done differently (technologies, institutions, business models, city planning processes, natural resource management, etc.). Managing that change in a cohesive, inclusive and just way is not only a moral obligation but also necessary for a successful transition. We have in our hands a much more attractive, sustainable, inclusive and resilient form of growth and development. With low interest rates, excess global savings and new, changing technologies, we can finance the transition to a zero-carbon economy. The challenge is to translate investment opportunities into real projects and programmes, finance them and thus scale up action with ambition and urgency.