Finance Watch

Making finance serve society

Building a financial system for a sustainable future

Finance Watch's blueprint on sustainable finance

Following the crisis, the G20 set a financial reform agenda focused on the prudential perspective: "making finance not hurt society". Ten years later, the current momentum around sustainable finance brings us back to the more fundamental question of **finance's purpose in society**. World leaders have agreed some ambitious societal objectives, such as the Paris Agreement and the broader Sustainable Development Goals (SDGs), and the need to re-direct financial flows to support these is obvious to all.

The elephant in the room is that the transformation of the financial system over the past three decades – sometimes referred to as a **"financialisation" of the economy** – has contributed significantly to accelerating environmental degradation, increasing inequalities and a weakening of social protection standards. Suggesting that finance can support a transition to a sustainable economy means turning this approach on its head. For finance to become truly sustainable, we need to think differently about its development and about how it impacts on society and the economy.

1 Define the sustainability track of the economy

In order for the financial system to serve society, society's needs must be defined. The Paris Agreement and the SDGs are statements of intent: they fall short of being a roadmap for action. We need to translate them into detailed national plans, with the necessary international coordination, to make these objectives a reality – including milestones to transform the economy sector by sector. **Only then can society prioritise its financing needs**, the corresponding optimal design of the financial system and concrete financing mechanisms, structures and products. Without this step of defining society's financing needs, policymakers in charge of the global financial architecture, regulators and practitioners within existing financial institutions (public or private) are walking blindfolded.

2 Implement economic regulation

Achieving sustainable development means hard-wiring sustainability in the economy, by changing the nature of economic incentives. We cannot pretend to decarbonize our economy when only 15% of CO_2 emissions worldwide are priced, at an average price of $ 22 per tonne – when the price required to shift to a low carbon economy is in the range of $ 50 to 80 per tonne. It is not only carbon emissions that need to be priced, but also other greenhouse gas emissions, all degradations to natural capital including water, carbon sinks and biodiversity, and harm caused to social and human capital. **Pricing negative environmental externalities is a prerequisite to sustainability.**

3 Stabilize the financial system

The financial system's instability is a key obstacle to the long term investments that the shift to sustainability requires. The leverage of Global Systematically Important Financial institutions is still too high and substantial risks remain on their balance sheets, including threats such as the excess levels of private and public debt, the global imbalances in financial markets, the absence of an international monetary system and the distortion of interest rates caused by the G7 quantitative easing policies after the crisis. **The fragility of financial institutions is a source of instability for governments and investors** who know they may have to rescue them. The other side of this coin is that bank shareholders, with comparatively little equity at stake, are able to benefit from risk-taking, such as placing bets on derivatives markets or lending to shadow banking entities whose risk-taking activities are not controlled. **Structural reform and an ambitious and binding cap on leverage** would reduce bank shareholders' appetite for speculative risk, fostering them towards other operations such as long term lending to the real economy. It would also shield the governments' balance sheet and society from the threat of bank bail outs.

4 Make the offer of public and mission-oriented finance great again

Finance can indeed play an important role in the transition, because the financial system allocates capital to the investments that will shape tomorrow's economy. The core issue is direction. It is also where the fundamental problem lies: through 30 years of liberalisation and deregulation, **we have mainly abandoned efforts to guide the direction and flow of capital to markets**. Yet the multiple crises that we face today – climate change to name but one – require urgent direction. Getting the transition on track will thus involve significantly **the balance sheet of governments and the whole range of mission-oriented financial institutions**, public or stakeholders governed, for which climate change or the SDGs are not a risk or an opportunity among others, but their key focus.

5 Make financial markets serve society via regulation

As well as creating economic incentives, stabilising financial institutions, and equipping public finances to support the transition, we need to regulate private financial institutions so that they are incentivised to serve sustainability. A good start would be to **restore some degree of democratic oversight of credit and capital creation and allocation**, so that banks and financial markets cannot ignore or undermine sustainability goals. It is also important to standardize the definition of sustainable finance products and services. The **standards** should be drawn up by governments in line with their sustainable economy objectives. While some metrics are already well developed such as CO2 emissions, there is the need to work on **data** in many other areas of natural capital conservation, such as water pollution, soil degradation or protection of biodiversity. The development of **metrics** is also a pre-requisite for the pricing of externalities. The **reporting** from investors should be standardized, so that the contribution of a given category of investors or investment products can be measured at global level. Sustainable investment **labels** could be delivered by a public agency, again in line with policy objectives. The **legal duties of investors** should include sustainability investment objectives, defined not by themselves but with reference to **suitable external standards**.

6 Engage individual investors and enable financial sector workers

Individual investors have appetite for more sustainable investments. This appetite is bound to increase when a significant amount of savings passes from the baby boomers to the millennial generation in advanced economies over the next two decades. **The push from individual depositors and savers is an important driver** for the financial system and governments to accelerate the shift to sustainability. They will benefit from better information about and promotion of sustainable finance products. **Financial sector workers can also play a role** by being empowered to change their organisations from within and provided with a mandate to act in the long-term best interest of their clients.