

2030 AGENDA FOR SUSTAINABLE DEVELOPMENT

Aligning financial system architecture and innovation with sustainable development

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Abstract

Finance is a keystone to the successful implementation of the Agenda 2030 but significant barriers exist to securing adequate public and private financing to achieve the Sustainable Development Goals. A broader strategy is needed to align the systemic features of finance and its relationship with the universally-embraced 2030 Agenda. The G20 has a central role in shaping the future direction of the global financial system, and given G20 Leaders commitment to further align the G20's work with the 2030 Agenda, the policy brief considers ways in which the G20 could advance such a systemic strategy.

Challenge

Since 2015, G20 Leaders have committed to further align the G20 work with the 2030 Agenda. This alignment both as a policy framework and through distinct aspects is indispensable to fulfil the G20's mission to advance "strong, balanced, sustainable and inclusive economic growth." In 2018 G20 themes include the future of work, the energy transition, climate and sustainability, financial inclusion, sustainable finance and the digital economy, which are all central elements of the 2030 Agenda.

Finance is a keystone to the successful implementation of the 2030 Agenda.

- The Commission on Business and Sustainable Development estimates that it has imbedded new business opportunities that could unlock US\$12 trillion.(1)
- The OECD 'Investing in Climate; Investing in Growth' report to the G20, highlighted the upside growth, productivity and jobs potential of climate-smart infrastructure investment.(2)
- The ILO has reported that implementing policies to promote a green economy will create twenty-four million new jobs globally by 2030.(3)

Significant barriers can exist to securing adequate public and private financing for the 2030 Agenda.

- Public financing is constrained by: (a) growing/competing demands, (b) high levels of indebtedness, particularly since the financial crisis, and (c) the corrosive effects of corruption, illicit financial flows and tax evasion.
- Private financing is constrained by: (a) returns below-market-expectations, (b) ineffective assessments of sustainability related risks and



opportunities and (c) perverse incentives leading to short-termism.

Positive actions are being taken to overcome policy and market-driven barriers and close the financing gaps, including in: economic, industrial, environmental and social policies; innovative financing mechanisms; and actions to improve financial integrity. More information available in the Appendix.

Measures are increasingly being taken to overcome barriers across the global financial system. These include a mixture of national and regional actions; international voluntary collaborative initiatives; and inter-governmental cooperation. More information available in the Appendix.

However, even with this progress, today's financial system does not channel global savings to much-needed, productive investments that could underpin sustainable development.

- The global context of low interest rates is causing many pension funds to question how to meet their long-term fiduciary responsibilities, especially given trends of ageing populations. Meanwhile, investments that could deliver sustainable development outcomes and returns to investors, remain unfinanced.
- Investments in clean energy infrastructure totalled US\$324 billion in 2016, however investment in fossil energy use was over US\$800 billion.(4)
- Green bond issuance has increased by several orders of magnitude over the last decade, but remains less than 1% of total bonds issued globally.(5)

The urgency to act indicates the need for a broader strategy that aligns the systemic features of finance and its relationship with the 2030 Agenda. The Paris Agreement Clause 2.1.c commits signatories to aligning financial flows with climate goals. Central bank governors and CEOs of leading financial institutions are calling for system level action. In the G20 space catalytic actions with high potential for timely, system-level change that would benefit from international co-operation need to be the focus, whilst recognising the value of smaller scale and long-gestation initiatives.

Proposals

The G20 is well placed to advance the 2030 Agenda through its central role in shaping international cooperation in economic and financial policies and practices.



The remainder of this brief therefore focuses on ways in which the G20 can more ambitiously advance the alignment of the global financial system with the 2030 Agenda.

Aligning the financial system with the 2030 Agenda is a matter of harnessing major change opportunities. Given the complexity and dynamism of this system, it is not possible to create a blueprint for the solution. Instead what is needed is to progress the 2030 Agenda by leveraging major, emergent changes that are taking place. For example:

- Financial crises offer major opportunities to reshape aspects of the financial system, such as following 2008, which addressed some of the root causes of that crisis – but new vulnerabilities are now emerging.
- International political agreements offer opportunities to shape systemic outcomes, such as the Paris Agreement which has helped system-level initiatives to advance climate considerations across the financial system.
- Major investment programs such as China's Belt and Road initiative, which provide opportunities to influence the alignment of major investment flows, as well as their broader policy economy effects.

Two topics focused on here are the opportunities for sustained, system-level intervention in aligning the financial architecture and the digitalisation of finance with the 2030 Agenda.

- Financial architecture refers to the rules governing the financial system, and concerns the roles of financial policy makers, regulators, standard setters and market-based rule-makers such as rating agencies and securities and derivatives exchanges.
- Digitalisation of finance refers to the impact of a complex, evolving technological eco-system on the financial system, including mobile platforms, big data and artificial intelligence, blockchain, crypto-assets and the internet of things.

Crucially, the G20 is one of the main, inter-governmental platforms through which policy and practice is debated and determined in shaping the international financial architecture and the digitalisation of finance. Indeed, there are distinct work streams under the Argentine Presidency that explicitly bridge both areas with the 2030 Agenda, including:



- Financial architecture: the G20 Eminent Persons Group on Global Financial Governance, formed under Germany's G20 Presidency, which has adopted the 2030 Agenda as the 'fit-for-purpose' test in its review of the fitness of the international development finance community to provide financing for the 2030 Agenda, and in exploring the IMF's role in supporting an effective financial architecture.
- Sustainable digital finance: the connection between aspects of sustainable development and the digitalisation of finance are being considered, in particular, by the Global Principles on Financial Inclusion, the G20 Sustainable Finance Study Group, the Energy Transition Working Group, and the Digital Economy Working Group.

These are of course not the only disruptions to the financial system that could be harnessed. However, these two, individually and together, will transform the financial system over the coming years, and alter the ways in which it impacts the real economy. Also, both offer the underlying tools and pathways to leverage other change opportunities, such as those highlighted above.

The focus topics of this briefing paper are already the subject of numerous G20 work streams, enabling the proposals to be both directed at these work streams under the Argentine Presidency, and signalled more broadly for consideration by future G20 Presidencies.

1. Integrating the 2030 Agenda into the Governance of the Financial System

Proposal A. Alignment: governance of the financial system needs to take the 2030 Agenda systematically into account. Acceptance that the ultimate purpose of the financial system is to effectively ensure strong, sustainable, balanced, and inclusive growth over the long-term, which in turn ultimately requires all aspects of financing to be aligned with sustainable development, as agreed by UN Member States as the 2030 Agenda.

One key implication is the need to integrate the 2030 Agenda into governing mandates (or the norms of their interpretation) of financial policy makers, regulators, standard setters and market based rule setters. This would bridge regulatory and policy matters whilst maintaining the fundamental tenet of regulatory independence from short-term policy pressures. This approach is supported by authoritative think tanks such as the G30, who believe that regulatory approaches need to be aligned to long-term policy objectives.



In practice, this all-important nexus between policy and financial regulation remains an ad hoc, less-than-visible domain. Some regulators have embraced sustainable development as an over-arching framework, such as the Dutch central bank. Others, such as the Bank of England, are exploring how climate change relates to their financial stability goal. Yet others, such as the People's Bank of China, have emerged as champions of green finance, thereby supporting the long-term development of China's domestic economy. The Network of Central Banks for Greening the Financial System exemplifies progress in this sphere, and should be encouraged and supported by the G20.

Required is that the G20 advances a more systematic approach to aligning the mandates of institutions governing the financial system with the 2030 Agenda. Specifically, such institutions should adhere to a commonly agreed set of principles concerning the 2030 Agenda developed through the G20, similar to the development of the Global Principles on Financial Inclusion. Such principles could also be recommended by and developed from the work of the G20 Eminent Persons Group on Global Financial Governance, and contributed to through the work of the G20 Sustainable Finance Study Group. In the meantime, governing institutions in G20 countries should be required to report on the potential impact of proposed measures on the 2030 Agenda outcomes, and over time their actual impact.

2. Improving the Impact of the Development Finance Community

Proposal B. Enhanced Collaboration: development finance institutions (DFIs) need to scale up their impact to drive transformative change and mobilize private financing on an unprecedented scale. The mandate and unique financial structure of DFIs allows them to leverage public contributions and multiply them into low-cost financing for sustainable development. Better policy and operational coherence among DFIs, along with governance reforms to embrace the prudent management of risks and a results-orientation aimed at achievement of the SDGs, would contribute to their enhanced impact.

Specific developments, in the main being considered by the G20 Eminent Persons Group on Global Financial Governance, include: (a) common principles of operation governing standards, including transparency, (b) joint efforts on diagnostic work and improving data; (c) platforms for project preparation and application of common standards and benchmarks including for sustainable infrastructure; (d) knowledge platforms and tools for strengthening policy and institutional foundations and provision of technical assistance; and (e) cooperation on establishment of financing structures that can unlock investments at scale. More broadly, a governance framework that periodically establishes and takes stock of system-wide results would generate greater accountability.



Proposal C. Engage with All Countries: there is a need to consider the interests and situation of all developing countries, in shaping policies and implementation modalities. At present, fragile and conflict/violence affected states are poorly served with important gaps in the financial architecture linked to the financing of rule of law and security institutions. Furthermore, there is little attention given to the impact of inadequate or inappropriate financial flows on countries susceptible to fragility and conflict. There is also a gap in inclusion of large, new bilateral lenders into existing debt resolution mechanisms. Options are limited to help upper middle-income states that serve as buffers against refugee crises and other external shocks.

3. Improving the Alignment of Financial System Architecture with the 2030 Agenda

Proposal D: Aligning Regulation of Finance: national action and international cooperation in managing the international financial system and the monetary system need to take the 2030 Agenda into account. Actions taken related to stability and market efficiency, as enablers of balanced, sustained growth, may not be aligned to the needs of the 2030 Agenda and the Paris commitments on climate. Adjustments to consider include:

- A.** Requirement that measures emerging through international cooperation on financial architecture, including financial market standards, be subjected to publicly available assessments (prior and ongoing) of potential impacts on the sustainable development goals and climate outcomes.
- B.** Internationally applied performance assessment methodologies, such as the IMF's Article IV and the IMF/World Bank's financial sector assessment program, and domestic financial market development plans, take explicit account of climate and the 2030 Agenda.

In executing such measures, there is a need to consider any implications for the governing mandates of key institutions, such as the IMF, and take greater, explicit account of the impacts on, and the concerns and needs of developing countries.

4. Harnessing the Digitalization of Finance for the 2030 Agenda

Proposal E: Advancing Sustainable Digital Finance: the digitalization of finance needs to be aligned with the 2030 Agenda as it evolves. Increasing attention is being paid to the effects of digitalization on the financial system, including in a fragmented manner aspects of its impact on the 2030 Agenda, such as financial inclusion and



aspects of environmental and climate considerations.

The G20 should advance a more systematic assessment of the existing and potential impacts of the digitalisation of finance on the 2030 Agenda. This requires moving beyond the present ad hoc treatment of this nexus. One option would be to contribute to the UN Secretary General's Task Force on Digital Finance and the 2030 Agenda, possibly through the Sustainable Finance Study Group. Aspects to consider might include:

- A. How digital finance could best support financing the 2030 Agenda, covering a broad technological eco-system and all the SDGs.
- B. How to ensure that the 2030 Agenda is embedded as a normative principle in the development of technical protocols and governing standards, and the governing arrangements themselves.
- C. How to secure citizens' rights as digital finance evolves, and their capacity to make improved choices through adequate user facing labelling and standards.
- D. How to ensure that the 2030 Agenda is reflected in the nexus between digital finance and fiscal and public procurement support, accelerator hubs and other policy supported development pathways.



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This Policy Brief has benefited from the discussions with, and feedback from the other co-Chairs of the Task Force on the 2030 Agenda, and participants of the sustainable finance work-stream, including Venkatachalam Anbumozhi, Alexander Barkawi, Fiona Bayat-Renoux, Michele Candotti, Pedro Conceicao, Iain Henderson, Felicity Perry, Bartłomiej Kolodziejczyk, Paula Lucci, Marcos Mancini, Chelsea Markowitz, Susana Nudelsman, Andrey Shelepov. Any errors and omissions remain the sole responsibility of the authors. Comments are welcome and should be sent to simon.zadek@un.org.



Appendix: Examples of current areas of action and measures across the financial system

Actions are being taken to overcome policy and market-driven barriers and close the financing gaps, including in:

- Economic, industrial, environmental and social policies, such as explicit measures to align national planning with sustainable development objectives.
- Innovative financing mechanisms, from impact investing and green bonds to deploying public finance and leverage private capital ('blended finance'), including development finance institutions enhancing the use of international concessionary finance.
- Actions to improve financial integrity such as reducing corruption and illicit financial flows, anti-corruption measures, and enhanced tax cooperation, with international cooperation through the OECD and the UN, and with the G20 playing a central role in anchoring some recent breakthroughs.

Measures are increasingly being taken to overcome barriers across the global financial system, from low-hanging fruit such as enhanced risk assessment and reporting requirements, to adjustments in the standards and governing mandates of financing institutions. Notable areas of growth:

- National and regional action, including the European Commission's strategy for sustainable finance, the Chinese State Council's action plan to green China's financial system, and national sustainable finance road maps in G20 and non-G20 countries.
- International voluntary collaborative initiatives, including: (a) long-standing coalitions such as the Principles for Responsible Investment, the Sustainable Banking Network and the Sustainable Stock Exchange Initiative that grew from the leadership of stock exchanges in Brazil and South Africa, and (b) recent initiatives such as the Dutch-chaired, Network of Central Banks on Green Finance, and the Swiss-based, Sustainable Digital Finance Alliance founded by UN Environment and Ant Financial Services.
- Inter-governmental cooperation, often involving private sector contributions, including through the G20 such as the Financial Stability Board's Task Force on Climate Related Risk Disclosure, the Green Finance Study Group (now the Sustainable Finance Study Group), the Global Principles for Financial Inclusion, the finance aspects of the Climate and



Sustainability Working Group, and the Eminent Persons Group on Global Financial Governance (using the 2030 Agenda as its 'fit-for-purpose' test)

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