Mark Carney: The Sustainable Development Goal imperative

Remarks by Mr Mark Carney, Governor of the Bank of England and Chairman of the Financial Stability Board, at the United Nations General Assembly, High-Level Thematic Debate on Achieving the Sustainable Development Goals, New York City, 21 April 2016.

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1. The SDG imperative

The Sustainable Development Goals are a moral imperative, with objectives that include nothing less than ending poverty, fighting inequality and injustice, and tackling climate change.[1]

The SDGs are also an economic imperative. Their achievement would mean greater productivity, increased labour supply and ultimately stronger growth. In short, they could pull the global economy out of its current malaise of secular stagnation.

2. The scale of investment required to achieve the SDGs is immense

Achieving the SDGs will require both a step change in the quantum of investment and a marked reorientation of its destination.

Over the next 15 years, the global population is expected to grow by just over a billion.[2] Another one and a half billion people are expected to urbanise.[3]

Although moving to a low-carbon future will not necessarily require substantially more investment than business as usual,[4] it will require a radical re-focusing of that investment from high- to lower carbon technologies.

Overall, it is estimated investments of between US$5 and $7 trillion a year are needed for infrastructure, clean energy, water, sanitation, agriculture, and the other SDGs.[5] This is significant but achievable.

3. Building the financial system we need to deliver this investment

While they are important catalysts, private niches, like social impact investing, or public sources, like Multilateral Development Banks won't be sufficient.

Achieving the SDGs will require mainstream finance.

To get enough finance in the right places will require more than just fixing the fault lines that caused the last crisis.

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[1] At the United Nations Sustainable Development Summit in September 2015, world leaders adopted the 2030 Agenda for Sustainable Development, which included a set of 17 Sustainable Development Goals (SDGs). The SDGs aim to end poverty, hunger and inequality, support action on climate change, improve access to health and education, and build strong institutions and partnerships, over the next 15 years. For further detail on the goals, see www.undp.org/content/undp/en/home/sdgoverview/

[2] Population growth figures from United Nations, Department of Economic and Social Affairs, Population Division, "World Population Prospects: The 2015 Revision".

[3] Urbanisation growth figures from United Nations Population Fund, www.unfpa.org/urbanization

[4] See New Climate Economy "Infrastructure investment needs of a low carbon scenario" (2014), which estimates that there are infrastructure investment needs totalling approximately US$90 trillion between 2015 and 2030, in the context of a growing population and increasing urbanisation. It is estimated that adopting a low-carbon pathway increases these costs by 5%.

[5] See UNCTAD "World Investment Report" (2014), which estimates that this is the annual amount of investment required to meet the SDGs by 2030.

We need to build a new system – one that delivers sustainable investment flows, based on both resilient market-based, and robust bank-based, finance.

We need finance for the long term.

We need a financial system that is F-A-I-R: that is Fair, Aligned, Inclusive and Resilient. Let me expand briefly on each, beginning with fairness itself.

(i) Fair

The twin crises of solvency and legitimacy undermined trust in market mechanisms and the effectiveness of the financial system. Banks were undercapitalised, mismanaged and operated in a privileged heads-I-win-tails-you-lose bubble. In parallel, there was widespread rigging of some markets for personal gain.

By replacing such implicit privilege with the full discipline of the market, social capital is now being rebuilt and economic dynamism restored.

G20 leaders have endorsed a wide range of measures to end too-big-to-fail in banking.

The Financial Stability Board[6] is now working on a series of initiatives to make the system more fair and effective, including examining governance and compensation arrangements to ensure they promote good, and punish bad, behaviour.[7] In the UK, authorities are pursuing reforms that will increase individual accountability, particularly in wholesale financial markets.[8]

Such initiatives are beginning to turn the tide of ethical drift which has plagued the system and would hold back the SDGs if left unchecked.

(ii) Aligned

Aligning incentives will increase finance's potential to support the SDGs. Alignment requires transparency. Consider the example of climate change.

Financial policymakers will not drive the transition to a low-carbon economy. Only Governments can solve the Tragedy of the Horizon.[9]

Financial policymakers can amplify the impacts of those decisions, while ensuring the financial system remains resilient during the transition. With respect to climate, our role is to develop the frameworks for markets to adjust efficiently.

Financing the de-carbonisation of our economy is a major opportunity for investors. It implies a sweeping reallocation of resources and a technological revolution, with investment in

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[6] The FSB brings together national authorities responsible for financial stability from the G20 and other major financial centres, international financial institutions and standard-setters. The FSB also conducts outreach with 65 other jurisdictions through its six regional consultative groups.

[7] As summarised in the "FSB Chair's letter to G20 Ministers and Governors on Financial Reforms – Progress on the Work Plan for the Hangzhou Summit" (February 2016), the FSB is working on reducing misconduct risk, including exchanging best practices on governance frameworks and potentially developing a supervisory toolkit or guidance; examining the effectiveness of post crisis reforms to compensation and whether disincentives to misconduct should be strengthened; and sharing national experiences on bank regulators' enforcement powers.

[8] See Bank of England "Fair and Effective Markets Review – Final Report" (June 2015), which sets out recommendations to help restore trust in the wholesale Fixed Income, Currency and Commodity (FICC) markets including: raising standards, professionalism and accountability of individuals; improving the quality, clarity and understanding of FICC trading practices by firms; strengthening the regulation of FICC markets by UK regulators; and improving international standards in this area.

[9] See Carney (2015) "*Breaking the Tragedy of the Horizon – climate change and financial stability*".

long-term infrastructure assets at roughly quadruple the present rate.[10] Transparency is critical to recognising the risks and seizing the opportunities of this transition.

Improved disclosure is necessary to reveal how the valuations of companies that produce and use fossil fuels might change over time. It will expose the likely future cost of doing business, of paying for emissions and of tighter regulation. By doing so, it will build a "market" in the transition to a 2 degree world, allowing firms and market participants to take a view on the transition path. With improved disclosure, climate sceptics and evangelists, techno-optimists and pessimists, alike will be able to back their convictions with capital.

The current fragmented reporting practices prevent investors, creditors and underwriters from taking these decisions on a fully informed basis.

That's why, at the request of G20, the FSB established an industry-led Task Force at COP21. Chaired by Michael Bloomberg, it is in the process of developing consistent, comparable, reliable and clear disclosures around climate-related financial risks.

The Task Force has just published its phase 1 report for public consultation in advance of its final recommendations to G20 Leaders over the next year.[11]

Improved private disclosure will also support public climate action.

Better information will allow policymakers to assess companies' speed of adjustment relative to countries' nationally determined contributions (NDCs). It will support more informed policies, including early responses if there are clear shortfalls. Virtuous circles could be more quickly established. If Governments build credibility by implementing their NDCs, this will raise the probability of further action to achieve 2 degrees. Markets can then do what they do best and pull forward that adjustment.

Early awareness of the risks and opportunities associated with a low-carbon economy will attract mainstream institutional capital. That impact will be maximised if there are the right vehicles.

In this regard, green bonds have the potential to align the interests of issuers and investors. To investors, green bonds offer a stable, rated and liquid investment with long duration. To issuers, they could tap the US$100 trillion global institutional fixed income investor base. Moreover, the shift to the capital markets from banks will free up limited bank balance sheet capacity for early-stage project financing and other important infrastructure lending.

At present, with less than one percent of outstanding bonds globally being "green", the G20 is considering initiatives to catalyse this market, including:

- Developing a "term sheet" of internationally recognised standardised terms and conditions to make issuance more efficient;
- Creating voluntary certification and validation frameworks to give certainty to issuers and investors that a project is "green";
- Integrating environmental risk and green certification into credit ratings;
- Developing green bond indices to unlock the potential power of passively managed investments;
- Standardising and harmonising principles for green bond listings to promote resilient and efficient trading and adequate liquidity; and

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[10] The IPCC estimates that additional investment of US$190–900bn is required annually in the energy sector alone if the rise in average global temperature is to be capped at 2C. www.ipcc.ch/report/ar5/ Mercer estimates that additional cumulative investment in efficiency improvements, renewable energy, biofuels and nuclear, and carbon capture and storage could be in the range of US$3-5 trillion by 2030. www.mercer.com/insights/point/2014/climate-change-scenarios-implications-for-strategic-asset-allocation.html

[11] See the Task Force on Climate-related Financial Disclosures "Phase 1 Report and Public Consultation" available at www.fsb-tcfd.org/phase1report/

- Evaluating mechanisms for consistent, transparent dispute resolution processes.

We all know the paradox that, as climate risks are a function of cumulative emissions, earlier action will mean less costly adjustment. Better climate disclosure and an effective green bond market will mean more investment with foresight and less regret in hindsight.

(iii) Inclusive

Inclusiveness is at the heart of the SDGs, and it must be at the heart of financial reform.

However, recent years have seen a worrying decline in correspondent banking services, with local banks and money service businesses in numerous regions losing access to the global banking system.[12]

The impact, in terms of unfulfilled economic potential, lost access to finance, and the break on sustainable development, is more than financial. Financial abandonment also has social, economic and security consequences. Communities that become financially excluded become vulnerable, particularly where lost banking services cut off income flows from remittances.

Our shared challenge is to combat money laundering and terrorist financing while reversing financial abandonment. These aims are entirely compatible. Keeping flows inside the financial system, and subject to stringent due diligence against clearly articulated standards, rather than forcing them underground is the way to ensure that the financial sector continues to serve real economies around the world.

To this end, the FSB, the World Bank and the IMF are implementing the four-point action plan endorsed by G20 Leaders. It is:

(1) Assessing the dimensions and implications of the issue;

(2) Clarifying regulatory expectations by working with the FATF and relevant countries;

(3) Expanding capacity through technical assistance in those jurisdictions whose firms have lost correspondent banking services; and

(4) Strengthening tools for due diligence by correspondent banks.

These efforts to reverse financial exclusion from the global system from termination of correspondent banking relationships can be complemented by greater use of financial technology to promote inclusion.

Over the past decade, mobile and web-based payment providers have dramatically expanded access to payment services, particularly in developing countries. Consider Vodafone's M-PESA since its launch in 2007. It has reached 23.4m customers across 11 countries, many of whom do not have bank accounts.[13] Meanwhile alternative lending models have opened up access to credit and investment. Examples include Faircent in India, which aims to provide credit on demand for all Indians, and Biva in Brazil which seeks to operate in regions traditionally underserved by banks.[14]

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[12] In responding to a recent World Bank survey, whose results are summarised in its October 2015 'Report on the G20 survey on de-risking activities in the remittance market', half of banking authorities, three quarters of large banks and a majority of local and regional respondent banks reported a decline in correspondent banking relations.

[13] Data from M-PESA, http://www.vodafone.com/content/index/media/vodafone-group-releases/2015/mpesa-ghana.html

[14] Data from Peer & Social Lending, http://peersociallending.com/investing/peer-to-peer-lending-sites-16-of-the-worlds-best/

If fully realised, recent developments – including expanded use of legal entity identifiers, know-your-customer utilities and even potentially distributed ledger technology – have the potential to restore correspondent banking services and remittance flows.

Financial technologies can redraw the parameters of the financial system and promote inclusivity and growth. To promote *sustainable* growth and poverty reduction, this must not come at the cost of less resilience. As such, the FSB is working to understand better both the potential benefits and risks technology poses to the financial system.

(iv) Resilient

I want to conclude by underscoring how fundamental the FSB's core mission is to achieving the SDGs. Without an open, global financial system that can support sustainable cross-border investment flows, there can be no sustained economic growth or financial contribution sufficient to achieve the development goals. In this way, the FSB's core work complements broader G20 initiatives to promote in inclusion, infrastructure, innovation and green growth.

Inevitably, since the crisis, the FSB's principal focus has been on agreeing reforms to fix the fault lines in banking that led to that crisis. Given the enormous progress made, we are now increasingly concentrating on building a diverse and resilient system that will harness the potential of market-based finance.

Since the crisis, market-based finance has grown significantly, bringing new sources of credit and investment, promoting financial openness and international capital flows, and adding welcome diversity to the system.

Emerging market and developing economies (EMDEs) have particularly benefited from these developments, doubling their stock of international bonds to US$2.8 trillion over the past five years.[15] And average annual portfolio flows to EMDEs have more than tripled from their average in the decade prior the crisis.[16]

For the SDGs to be achieved, such flows must be larger, more reliable and better utilised. That's why the FSB is now developing new policies to address liquidity, leverage and securities financing risks in asset management activities. These measures will help ensure asset managers can provide sustainable and reliable financing to EMDEs.

That's why the FSB is working to ensure the central counterparties that support the plumbing of the new system are resilient and can be resolved without disruption to the flow of financing to the real economy.

And that's why FSB members are working to develop more effective macro prudential policies. These will dampen the impact of capital flows on domestic vulnerabilities and allow countries to be more open and connected to global trade and investment.

The FSB's work plan is highly complementary to other G20 priorities in infrastructure, inclusiveness and climate change.

A FAIR system is essential if we are to move to a 2 degree world.

A FAIR system is critical to achieving the economic and moral imperatives of the SDGs.

I look forward to our discussion of how to build such a system to the benefit of all.

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[15] BIS International Debt Statistics, (all sectors, nationality basis).

[16] IMF World Economic Outlook data show that average annual portfolio flows to EMDEs have more than tripled from their average in the decade prior to the crisis to an average of US$257 billion annually between 2009 and 2015.