The Coalition of Finance Ministers for Climate Action

Strengthening the Role of Ministries of Finance in Driving Climate Action

Summary for Finance Ministers and Policymakers[1]

November 2022

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1. Introduction

Finance Ministries hold significant levers for accelerating climate action which are not being fully utilized to drive sustainable, inclusive, and resilient growth. Strengthening the role of Finance Ministries in climate-related policymaking will require substantial changes to governance and in-house functions. To do so will require further steps by Ministries of Finance to mainstream climate action into their organizational strategies and core policy areas, including through the budget process, tax system, and financial system. Finance Ministries will need to redefine their mandates and build the necessary leadership, coordination, staffing and analytical capabilities through far-sighted organizational reforms.

The Coalition report *Strategies for Mainstreaming Climate Action in Ministries of Finance: Governance, Capacities, and Research Practices* (February 2022) outlined concrete steps for how the Coalition could support climate mainstreaming. The Coalition concluded that deeper understanding of the actions and operational changes needed to drive progress, including through country case studies, would help to identify further best practices and ideas to support progress. As a next step, the Coalition agreed to develop **a guide for Finance Ministers** on mainstreaming climate action.

This summary note outlines how the role of Finance Ministers could be utilized to the full. It is possible for Finance Ministries to achieve their core priorities of macroeconomic and financial stability, and management of public finances, while driving decarbonization and enhancing resilience at heightened pace and scale. In the face of unprecedented crises, the transition can enable Finance Ministers to realize economic and societal opportunities for their citizens and avert significant risks to their economies, while driving sustainable, inclusive and resilient growth and development.

Achieving the above objectives will require close collaboration with stakeholders and Partners— especially relevant Ministries such as Environment, Climate, Development, Energy, Agriculture. The Coalition looks forward to initiating such discussions starting at COP27 and is launching a consultation with stakeholders with a view to setting out a Ministry of Finance Framework for Climate Action in early 2023.

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[1] This summary is based on a draft report prepared in a collaborative effort by over 30 individuals from member countries and institutional partners of the Coalition of Finance Ministers for Climate Action, coordinated by a team at the Grantham Research Institute on Climate Change and Environment at the London School of Economics and Political Science.

2. Why Ministry of Finance Leadership Matters for Climate Action and Economic Transformation

National governments worldwide are facing an unprecedented series of interlinked crises: an economic crisis in the form of slow growth, rising debt and challenges in recovering from COVID-19; a cost-of-living and energy crisis with high and rising energy and food price inflation and threats to energy security; and a climate crisis with rising incidence of climate hazards and wider environmental degradation, from floods and forest fires to extreme heat and biodiversity die-off, as greenhouse gas emissions continue to increase.

The response of far-sighted leadership would see public and private investment in creating the economy of the future, based on cheap, secure and clean energy, rather than turning to short-term macroeconomic fixes, scaled-back public investment, blanket energy subsidies and expanding domestic fossil fuels. The right policies would produce an economy with new forms of high value-added employment, and places in which people can live and work affordably and move around easily; and that is resilient to the impacts of climate hazards and protects vital biodiversity. This future economy is firmly within the grasp of today's leaders.

Capturing this triple economic, social and environmental dividend will require far-sighted leadership by national decision-makers, including Ministers of Finance. Decarbonization of every sector of the economy is required by mid-century, alongside significant efforts to boost resilience and protect natural capital. As centre-of-government bodies at the crux of coordinating economic and tax policy, mobilising investment, and managing implementation, and with their near-unique overview of a country's entire economy, Finance Ministries are crucial to a successful whole-of-government approach to climate action. They help shape country visions, strategies and investment plans. They oversee the expenditure of all main government departments – giving them direct or indirect control over one-third of global GDP, worth well over US$20 trillion. And they are regulators or shareholders in state-owned enterprises, development banks and the financial sector.

Scaling up climate action can help Ministers of Finance achieve their core objectives of macro stability, growth and responsible management of public finances. The prices of low-carbon solutions have fallen rapidly during the last 10 years and by 2030 these solutions could be competitive in sectors accounting for nearly three-quarters of emissions (Systemiq, 2021). Recent estimates suggest that a transition to net zero can generate net benefits worth US$26 trillion and create up to 65 million new jobs by 2030, outstripping job losses in polluting sectors (NCE, 2018). Resilience investments can have benefit–cost ratios of nearly five to one (Global Commission on Adaptation, 2019). And acting on climate now will help Finance Ministries to avoid fast-escalating risks with macro-critical consequences such as higher public expenditure for reconstruction of damaged infrastructure, write-downs of stranded assets, adverse impacts on the tax base, and rises in the cost of capital as rating agencies increasingly consider climate risk preparedness.

Ministries of Finance not only have the incentive to act proactively but also the experience to do so – from the COVID-19 pandemic, the 2009 Global Financial Crisis, and from rebuilding after World War II. They can be flexible, innovative leaders, tackling the challenges of the day to protect citizens and businesses. As identified by the Coalition of Finance Ministers for Climate Action, Ministries of Finance that can reimagine their roles and apply their qualities to tackle the immense risks from climate change and benefit from the opportunities of climate action will be at the forefront of the transition to a more prosperous, resilient future.

The Coalition of Finance Ministers demonstrates that Finance Ministers together can identify collective challenges and work jointly towards shared solutions. The benefits of the zero-carbon, climate-resilient economy can be captured more quickly and efficiently through collective efforts, on policies such as carbon pricing, international climate financing, investment in new technologies in hard-to-abate sectors and greening the global financial system to further drive down the costs of the transition.

Seventy-nine Finance Ministers have already recognized that the risks of climate change to economies are real and that their ministries hold important levers for accelerating climate action, by coming together and signing the Helsinki Principles. These six principles promote national climate action, especially through economic and financial policies and the use of public finance. And there is emerging evidence among Coalition members that there is growing awareness and involvement by Finance Ministries in climate action, especially from the last two to four years.

Ministries of Finance cannot act alone and should seek to promote a collaborative approach. Climate action is a story of structural transformation, investment and innovation across all sectors. This demands strong cross-agency collaboration and integrating climate action into all the decision-making of all government departments. While Ministries of Finance play a key role, Heads of State, Ministries of Environment, Energy, Transport, Planning and many others have an equally critical part to play – and many ministries have been acting on climate for decades. Finance Ministries need to match this effort and enable and support the climate leadership of other actors, including through national budgets. They should also be proactive in their areas of direct responsibility and in areas where shared responsibility will be critical. It is especially important that Finance Ministries work alongside and support Ministries of Environment and Climate in the key international climate processes, such as the UNFCCC Conference of the Parties and in designing national climate strategies.

The window to avoid dangerous climate change is narrowing rapidly. Yet there remains a substantial disconnect between the ambition of national climate strategies and the supporting policies and resources provided. The strategies are often driven by Ministries of Environment and the support usually mediated by Ministries of Finance. This shows up in the emissions and investment numbers. Following an unprecedented drop of 5.4% in 2020, global greenhouse gas emissions have bounced back to pre-COVID levels and continue to rise, with existing commitments still falling far short of delivering the 45% reduction scientists say is required by 2030. Less than US$650 billion of the more than US$4 trillion in annual investment needed to place us on a pathway to net-zero by mid-century was deployed in 2019/20 (CPI, 2022), while G20 governments provided nearly US$600 billion annually on average in fossil fuel subsidies from 2017 to 2019. Deep pockets of private capital remain largely untapped, hampered by market and non-market failures which lead to an undersupply of private capital for investment.

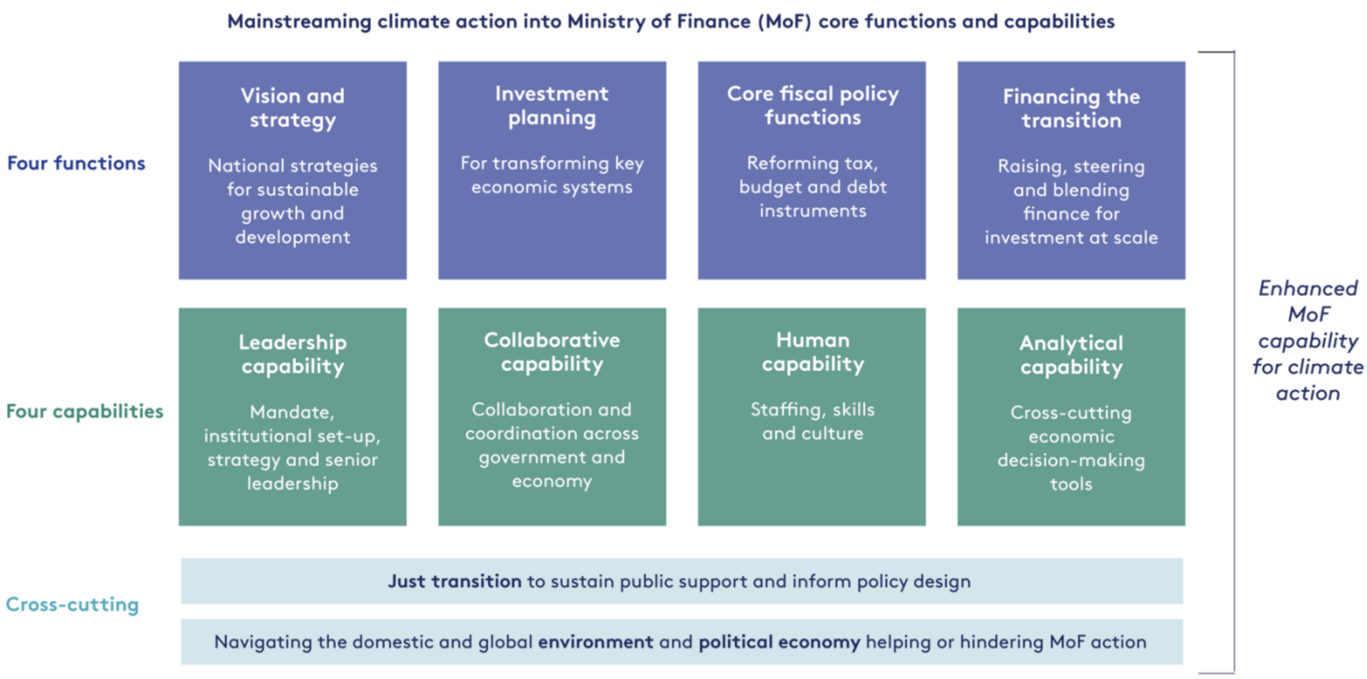
Global investment to mitigate and adapt to climate change needs to be increased and sustained above pre-pandemic levels by at least 2% of GDP per year, and closer to 3–4% in emerging markets and developing countries, and potentially higher (Bhattacharya et al, 2022, Songwe et al, 2021), in order to meet climate objectives. Capturing the transition's core economic and social dividends demands far-reaching policy reforms and investment in clean energy, urban infrastructure and transport systems, hard-to-abate industrial sectors, sustainable agriculture and forest protection, as well as in water management, the protection of natural ecosystems and measures to boost resilience against climate impacts. The increase in investment required means Finance Ministries must play a more proactive role across strategy, investment planning, economic policy and financing, including to help catalyse private and other sources of capital and avoid their continuing misallocation.

Finance Ministries will need to overcome the systemic barriers and institutional inertia that hamper their more active engagement in the climate agenda. It will be especially important for Finance Ministries to shift how they view climate action: from a cost to a unique growth and investment opportunity. And Finance Ministers must see the current energy crisis and growing incidence of climate hazards as an opportunity for more, not less, action, with a rapid switch to renewable energy presenting an opportunity for countries to deliver clean, cheap, secure energy and new employment at the same time. Some countries are already experiencing enhanced resilience to today's energy price shocks because of farsighted action taken decades ago.

Finance Ministries will need to overcome many other barriers impacting their day-to-day work, too, increasing their awareness of the most effective actions needed across relevant areas of public policy. Gaps must be plugged in knowledge about the costs and benefits, including distributional consequences, of different policies. Finance Ministries must confront a natural but acute risk aversion to new spending commitments, concerns about risks to the tax base from electrification and phasing out fossil fuels, aversion to the use of green taxes, fiscal incentives, and earmarking carbon price revenue, and a conservative approach to the active use of fiscal policy and non-market mechanisms. In some cases, there are considerable capacity constraints. Overcoming these barriers will not be easy but will pay off.

3. Proposal: A Ministry of Finance Framework for Climate Action

The following draft framework shows Finance Ministries how they could enhance their core functions and capabilities to act on climate, overcoming barriers to action. The framework suggests key entry points for mainstreaming climate action into Finance Ministries' **core functions** spanning macroeconomic strategy, investment planning, fiscal policy, and oversight or regulation of the financial and other sectors. All these policy areas are critical in creating an enabling environment for investment. Equal attention should be given to complementary organisational reforms to support implementation and consequently we set out **core capabilities** to be strengthened alongside. All these functions and capabilities intersect with relevant **Helsinki Principles** (HPs).



A more detailed description of the Framework is provided in the synthesis and full reports.

4. A Global Call to Action for Ministries of Finance

The framework identifies 15 transformative actions which, if embraced by Finance Ministries, would help to ensure implementation of the Helsinki Principles and would send a strong signal that the world economy is poised to follow a low-carbon, climate-resilient direction. Good examples of visionary leadership are already evident among Members of the Coalition of Finance Ministers for Climate Action and more broadly, which can serve as inspiration to others. An overview of some of these examples is provided in the Synthesis Report.

It is especially important that Ministries of Finance reform their own organisations to be fit for purpose. Implementation depends on country-specific circumstances and administrative practices, but progress will require efforts by Ministries of Finance to redefine their roles and invest in building the capability to act. They can enhance their climate leadership and capabilities by:

1. **Developing clear Ministry-wide strategies and working with Heads of State to enhance their mandates for climate action.** This can help to empower and enable Ministries of Finance to marshal the internal resources to play a more active role in mainstreaming climate action across all their key functions and across government. This enhanced mandate could come from legislation, the Government's overall programme, or be initiated through the strategy development process.

2. **Reforming internal institutional arrangements to ensure dedicated capacity for climate action.** This could include redefining senior-level responsibilities, new collaboration processes, and appointing designated and qualified staff as focal points. Where resources permit, establishing dedicated climate change units combining redeployment of existing staff and recruitment of new experts could be considered. Strategies could include designating a small team to coordinate work on climate change, with a large bulk of work being done within the existing teams.

3. **Actively participating in inter-agency and stakeholder coordination and ensuring a whole-of-government approach to climate policy.** At a minimum, Ministries should consider identifying areas requiring collaboration and participation of the Minister and Ministry of Finance in existing inter-ministerial coordination mechanisms and allocate resources accordingly.

4. **Investing in new skills and expertise to drive climate action and investment.** This can be done through in-house training, recruitment, engagement in peer-to-peer networks such as the Coalition of Finance Ministers, engaging with academia and other knowledge providers, and by leveraging expertise from other agencies. Finance Ministries can start by assessing specific skill gaps and developing training and hiring plans.

5. **Investing in a range of enhanced economic decision-making tools and approaches** to improve the quality of decision-making by assessing climate and transition impacts and the costs, benefits and fiscal impacts of different pathways and investments. This should include overcoming the shortcomings of traditional general equilibrium and cost–benefit analysis approaches by capturing non-linear climate impacts and non-marginal changes in the economy.

Enhancing these capabilities will allow Ministries of Finance to go faster and further in driving climate action and investment across the core functions identified above. The areas in which Ministries of Finance can have the most significant immediate impact based on their primary responsibilities include:

6. **Actively using the full suite of fiscal policy measures to transform macroeconomic incentives for climate action and investment**. Finance Ministries should design coherent smart policy packages that address multiple market and non-market failures and enable them to capitalise on the strong interactions between fiscal instruments while avoiding contradictions. This should include

ambitious carbon pricing schemes and subsidy reforms supplemented by other fiscal incentives and regulatory reforms to transform economic systems.

7. **Paying particular attention to active use of the annual budget process and medium-term expenditure frameworks to drive transformation of all sectors of the economy** to deliver on national climate objectives. This should include the responsible use of debt financing (including green bonds) for investment and greening public procurement. And it should include addressing the significant impacts that climate-related risks might have on the economy and public finances, including through identifying and planning for known and unknown contingent liabilities through investments to enhance economic resilience.

8. **Reviewing and redesigning the overall tax system for net zero and climate resilience.** Domestic resource mobilisation to underpin investment in the transition is critical. Ministries of Finance should commit to making a net zero tax strategy a key element of budget processes and to future-proofing future tax policy changes. This should include identifying new sources of tax revenue for sustainable infrastructure investment and to prevent unplanned declines in tax revenues on the production and consumption of fossil fuels. Potential sources might include new forms of environmental taxation, motoring taxes, road pricing, property and land taxation, reforming general taxation, and revenue from financial transactions, wealth or digital services. The renewable energy sector may even become a new source over time, once in its consolidation phase.

9. **Raising, steering and blending finance for investment at unprecedented speed and scale**, with a view to leveraging at least an additional 2% of GDP in public and private investment year on year for the next decade and beyond. Emerging markets and developing countries should look to go further than this, supported by the international community. This should include establishing multi-stakeholder platforms or taskforces to support the creation and implementation of Sustainable Finance Roadmaps for the public and private sector, including greening the financial system, the development of disaster risk insurance for all, and the potential use of blended finance and country platforms to help aggregate investment pools. It should also include working closely with sub-national governments to increase investment in sustainable urban infrastructure, including public transport systems (especially important post-COVID-19).

10. **Leveraging international climate finance and encouraging the strengthening of the global financial architecture**, working hand-in-hand with Foreign Ministries and development agencies. For countries eligible for official development assistance, their Ministries could develop climate finance strategies to detail the further investment needed to achieve Nationally Determined Contributions and Long-Term Strategies and proactively call for enhanced support for climate action by the regional and multilateral development banks through building coalitions for capital increases, stretching balance sheets, reforming lending limits, greater use of risk pooling and guarantee mechanisms, and Special Drawing Rights. Shareholders and other countries should continue to encourage an increase in international climate finance, especially concessional finance and finance for adaptation investments.

To be effective, these measures must be complemented by engagement in a broader suite of strategic policy areas. Ministries of Finance will need to play an ever-growing role either to support other government agencies or in a co-leadership role. This includes:

11. **Integrating climate action into national growth and development strategies**. This will help to ensure that climate action and economic development are achieved together. This should include supporting other ministries to develop industry, innovation, and sector strategies fit for the 21st century challenges of climate action and economic transformation.

12. **Supporting line ministries to develop fully costed national climate strategies** – including Nationally Determined Contributions, Long-Term Strategies and National Adaptation Plans – by

investing resources to engage in all phases of the process: planning, implementation, monitoring and revision and ensuring they are implemented by integrating them into core government processes. Finance Ministries should work with the respective lead agency to agree on clear roles and responsibilities and even consider taking on overall responsibility for planning and financing a roadmap for a net zero and climate-resilient economy.

13. **Developing sustainable, inclusive and resilient investment strategies** as part of the above processes. These should assess economy-wide and sector-specific investment needs, identify and outline steps for overcoming impediments to investment, including by building mechanisms for translating investment planning decisions into concrete programmes and pipelines of projects, and embedding national climate plans into public investment planning.
14. **Leveraging their shareholder positions in state-owned or regulated entities.** Strategies should include greening National Development Banks and Sovereign Wealth Funds and updating central bank responsibilities on monetary policy and regulation of the financial system.
15. **Working across all these policy areas and with other line ministries and stakeholders to develop just transition plans and policies for all key sectors of the economy.** At the heart of this should be ensuring climate policies consider potential positive and negative social impacts, and that affected stakeholders are included in decision-making.

5. Next Steps

All Finance Ministries—no matter how well resourced—will have to prioritise and sequence the steps they take. A one-size-fits-all approach will not work. Important differences exist between the mandates, organizational structures and corporate cultures of different Finance Ministries: some will be able to drive transformational reform, others may need to take a more step-wise, graduated approach.

Many Finance Ministries are broadly in the process of integrating climate action into their activities but can be supported to go faster and further through common reform strategies and assessing the right reform approach by undertaking organisation-wide capability reviews for net zero and climate resilience, which could be inspired by the framework outlined in this document. Such support would help Finance Ministers in setting the world on the path to a sustainable, inclusive and resilient future.

The Coalition looks forward to deeper dialogue with stakeholders on the role of Finance Ministers in driving climate action, starting at COP27. The Coalition is initiating an open consultation with stakeholders with a view to setting out 'a Ministry of Finance Framework for Climate Action' that would provide a guide for Finance Ministries to achieve progress. The framework would be launched in early 2023 and presented to Finance Ministers in April 2023.

6. Key Discussion Questions About Strengthening the Role of Ministries of Finance

1. How do you see the role of Ministries of Finance shifting in the context of the climate crisis?
2. What steps in the 15 action areas (and beyond) are the most critical ones to achieving progress?
3. How do you view the usefulness of the proposed framework?
4. What organisational and governance reforms would be needed to proceed?
5. What constraints would you see in the proposed framework in your country?