

Mainstreaming Climate into Economic and Financial Policies

This paper draws on the work of the Coalition’s six workstreams and the priorities set forth by its Members at the Ministerial meeting held on 12 October 2021, and has been prepared for the 2021 UN Climate Change Conference (COP26). The report describes the ongoing work and efforts of the Coalition, and does not represent an endorsement of any of the views expressed herein by any individual Member.¹

Climate change is elevating tangible risks, such as those to countries’ fiscal positions and financial stability. To move towards low-carbon and climate-resilient economies, governments need to take action. Ministries of Finance (MoFs), in particular, are responsible for preparing economic projections and impact assessments, and implementing economic, fiscal, and financial policies. As a result, climate change considerations need to be mainstreamed into their work. Since its establishment in 2019, the Coalition of Finance Ministers for Climate Action has worked to mainstream climate risks, and, more recently, risks stemming from biodiversity loss, into the daily work of Finance Ministries.

The economic and financial risks of climate change are real but can be contained through new economic and financial policies and tools.

Incorporating climate change considerations into decision making and identifying climate-related risks to economic and financial stability is crucial. To this end, the Coalition has analyzed climate-related risks to raise awareness and explored key risk management approaches. Research shows that climate-related risks may manifest in different sectors of the economy and alter underlying macroeconomic conditions. The ongoing threats and impacts caused by climate change means the interaction of various risks may lead to feedback loops that could gradually—or abruptly—generate high fiscal costs and trigger contingent liabilities for Finance Ministries. The materiality of these risks—posing potentially high ex-ante unknown fiscal costs—depends on the interplay of climate-related risk transmission channels, the degree of unfavorable feedback loops, the specific country context, and climate action measures. Evidence from Coalition Member countries shows that the fiscal costs of climate change can be significant.

“It is essential to recognize that a systemic change caused by climate change is taking place. We, Finance Ministers, must be able to understand the economic consequences of climate change and design our economic and financial policies accordingly”

**Annika Saarikko, Finance Minister of Finland
and Co-Chair of the Coalition**

¹ The views, findings, interpretations, and conclusions expressed are those of the authors and do not necessarily reflect those of the Coalition, its Members, or the affiliations of the authors.

The Coalition works to support the design and sharing of best-practice mitigation and adaptation measures to reduce the likelihood of severe climate-related impacts, as well as policies that support long-term economic development and financial stability. With finance ministries deploying climate informed policy levers, countries can better mitigate and manage climate-related risks.

A ‘whole-of-government’ approach is needed

Yet, new ways of thinking and acting are needed. A ‘whole-of-government’ approach can help ensure that change occurs on a systemic level. For that approach to be most effective, efficient institutional mandates that identify the clear role of Finance Ministries in the preparation of climate policies are required.

Mainstreaming climate requires major strategic changes within Finance Ministries and large investments in capacity building. Finance Ministries need strategies, expertise, and tools to cope with the challenges posed by climate change. Without a greater focus on climate change and developing these resources, Finance Ministries may continue with a limited understanding of the problem, which would hinder the achievement of both short- and long-term net-zero targets. With this in mind, capacity building plays a key role at the individual and institutional levels.

A changing climate is a threat to humanity. Mainstreaming climate change into policies can save us and lead to better-quality growth.

Sri Mulyani Indrawati, Finance Minister of Indonesia and Co-Chair of the Coalition

Finance Ministries can also support the design of climate policies through impact assessments. Based on a ‘whole-of-government’ approach in the process of planning, implementing, and communicating policies, the role of finance ministries should be clearly defined, and policies should be backed by robust analytical research. Stakeholder engagement is also very important. Public consultations, meetings, and other outreach engagements early in the process—typically

as soon as the government plans to introduce new policies—can improve policy design and implementation. Communicating policy goals and expected outcomes using simple, goal-oriented, and non-technical messaging can support stakeholder engagement and improve the design and implementation of policies.

The Coalition’s six Helsinki Principles provide a solid strategic framework for climate mainstreaming

The six Helsinki Principles form a comprehensive strategic framework with concrete policy components, which help Ministries of Finance integrate climate policies and design actions to address the climate crisis. The Coalition brings together relevant Institutional Partners (IPs) that contribute to the design and implementation of climate policies at the country level in multiple ways. Multilateral development banks and international organizations play a key role in supporting the efforts of Members to decarbonize and manage the impacts of climate change. As Members have incorporated the Helsinki Principles into their climate strategies, the Coalition encourages IPs to deepen their engagement based on the Helsinki Principles in their country level and regional activities.



First Sherpa Meeting of the Coalition

Helsinki, Finland

February 21-22, 2019

First Ministerial Meeting of the Coalition

2019 WBG/IMF Spring Meetings;
Washington, D.C.

April 13, 2019



Vatican Ministerial Visit

The Vatican

May 27, 2019

Second Sherpa Meeting of the Coalition

Santiago, Chile

June 4-5, 2019



The development of long-term strategies is central in the design of credible action to support a successful transition

Long-term strategies (LTSs): Aligning with the Paris Agreement has wide-ranging, structural implications for the economy, which can be supported by the development of long-term, low greenhouse gas emission, development strategies. Ministries of Finance and Economy can play an important role in the formulation and implementation of LTSs to address climate change. The Coalition has started to put concrete effort into developing LTSs, promoting measures that result in effective carbon pricing, integrating climate into macroeconomic policy, fiscal planning, budgeting, public investment management, and procurement practices, mobilizing private sources of climate finance, and engaging finance ministries in the development and implementation of Nationally Determined Contributions (NDCs).

Finance Ministries' engagement in the preparation of LTSs can help put countries on the path to net-zero greenhouse gas emissions by 2050. This involves both articulating targets and implementing policies and actions that are credible and include sufficient detail to shape national development plans that enable the achievement of the NDCs. To support the efforts of Coalition members, a report on long-term strategies for climate change was published and a survey on LTSs was launched.² The results of the survey carried out under Helsinki Principle 1 showed that:

- Finance Ministries often collaborate with, and are consulted by, other agencies—including the Ministry of the Environment—that lead the process of LTS development.
- More work needs to be done on adaptation, improvement of the Public Investment Management system, and parliamentary oversight.
- The Coalition's support is needed mostly on economic modelling and cost benefit analysis of decarbonization measures.
- There is strong value in involving Finance Ministries from the outset of LTS preparations. However, the exercise was considered burdensome, with coordination and collaboration between stakeholders being the biggest challenge.

The analysis of potential, major fiscal implications from the transition to a carbon neutral economy is at the heart of Finance Ministries' responsibilities. The Coalition is preparing a study conducted under the Helsinki Principle 1 workstream on the current practices related to analyzing and modelling the fiscal impacts of long-term climate strategies. The study also gathers recommendations and views from various global modelling experts on potential ways to improve the analyses further. The Helsinki Principle 1 workstream will build on these surveys and the results of the study to shape an impactful mainstreaming program.

Finance Ministries must develop expertise and know how to support climate action

Training and Research: The Helsinki Principle 2 workstream is generating insights on the concrete tools and actions, as well as changes in administration and governance arrangements, needed to support

² In July 2020 the Helsinki Principle 1 workstream published "Long-term strategies for climate change: A review of country cases" report.

mainstreaming in Finance Ministries. Within this workstream, the role of training and policy research have been identified as key elements in supporting evidence-based policy and decision making.

Training needs are strongly linked to institutional capacity building, especially in low- and middle-income countries. Finance Ministries need to acquire new knowledge and skills on climate economics through education programs backed by science and with an emphasis on the science-policy interface.

The Coalition is currently planning a training program and conducted a mapping of existing support available to its Member countries from institutional and academic partners. The aim is to support capacity building in Finance Ministries by facilitating training through courses offered by institutional partners and universities.

Members have indicated that high-level research is needed to bring information and knowledge to form the basis of economic policy-making. In this context, the role of timely policy-relevant research is essential. During the second part of 2021, the Coalition has been delving deeper into Members' research practices and a workshop on the topic was organized in late September.

Finance Ministries need to acquire increased knowledge of fundamental issues in climate economics and base their policy decisions on research. Interdisciplinary horizontal issues are important to ensure policy comprehensiveness. In this regard, many countries are already benefitting from high-level engagements with research institutes, but more continuous and interdisciplinary knowledge and support is required in complex areas like climate economics.

The design of reforms requires thorough impact assessments to ensure an equitable, inclusive, and orderly transition

The discussion at the April 2021 Ministerial Meeting recognized that pursuing net-zero targets requires a broad horizontal approach across a range of possible policy tools, including the use of carbon pricing (alongside complementary sectoral mitigation efforts), green budgeting, and measures to ensure a just, equitable, and inclusive transition. To facilitate regional and national solutions that work effectively together, attendees emphasized the importance of coordinated action and sharing of experiences. The discussion on climate risk management underscored the need for a comprehensive approach that takes into account the wider economic and fiscal costs of climate change that cause high vulnerability in many industries, sectors, and countries. Ministers gave their strong support to the Coalition to provide concrete advice on designing policy options. The Sixth Ministerial meeting deepened the discussion on these topics.

Carbon Pricing: It was broadly recognized that carbon taxation and emissions trading systems (ETs) can be the most cost-efficient instruments in providing an explicit price to carbon, and steering consumer and producer behavior towards the least carbon-intensive products and activities. The implementation of explicit carbon pricing instruments can provide important support to countries in reducing energy sector carbon dioxide emissions and transitioning to growth that is more reliant on low-carbon energy generating technologies. Reforming and phasing

“Carbon pricing is our most cost-effective instrument in the fight against climate change. If we implement carbon pricing wisely, in combination with other policies, it will help us ensure a transition that is just and works for all.”

**Nicolai Wammen,
Finance Minister of Denmark**

out inefficient fossil fuel subsidies and working in collaboration with other countries on the coordination of pricing measures could additionally ease potential trade frictions.

Macroeconomic Policy and Public Financial Management (PFM): Efforts to mitigate and adapt to climate change will affect the fiscal sustainability of government budgets in the medium and long term. The Coalition will work towards identifying methods for detecting, measuring, and managing fiscal risks and impacts arising from the effects of climate change, and efforts to mitigate these impacts through greenhouse gas reduction and building resilience. The aim will be to inform Finance Ministry decisions of where and how to limit impacts and risks to public budgets and showcase the experiences of leading countries.

Government plays a key role in the fight against climate change and should use public investment and policy to spur innovation, reduce emissions, and build resilience. The Coalition will work towards enabling Finance Ministries to develop and deploy effective tools of budgetary policymaking, policy assessments, macroeconomic modelling, and public asset management to help achieve climate-related goals. The aim is to strengthen Finance Ministries' capabilities to, as appropriate, analyze the effects and impacts of specific investments and policies, and to take action by implementing cost-effective measures and leveraging private investment.

[Mobilizing finance and investments will require a comprehensive understanding of climate related risks: this means fundamental changes in our financial systems](#)

Financial Policy: The Helsinki Principle 5 workstream aims to help Members mobilize private sources of climate finance by facilitating investment and the development of a financial sector that supports climate mitigation and adaptation. At the Sixth Ministerial Meeting in October 2021, Members recognized the importance of mainstreaming climate considerations in the financial system to mobilize private capital more effectively for climate action. They also recognized the importance of assessing and addressing climate-related financial risks so that the financial system is resilient to those risks and able to support the climate transition, and to better inform market participants. Through reports, workshops, and stakeholder dialogues, the Helsinki Principle 5 workstream identified recommendations for how climate change can be mainstreamed into a country's financial system. Key recommendations are outlined below.

- ***Climate-related financial risk management***³: Finance Ministries can support the development and implementation of policies to address climate-related financial risk, which can promote integration of climate considerations into financial decisions. Finance Ministries may be able to help promote climate-related risk disclosure, which can drive market participants and public authorities to identify and tackle sources of risk. Finance Ministries can work to promote better data, clarity on climate-related policies, and credible commitments for achieving the targets of the Paris agreement to inform climate risk reporting and exercises to assess climate-related financial vulnerabilities. There is potential for Finance Ministries, regulators, central banks, and supervisors to collaborate in key areas, including macro-financial risk assessments, forward-looking scenario analyses, and complementary policies that could jointly create incentives that enable an orderly transition.

³ In May 2021, the Helsinki Principle 5 workstream published *Climate-Related Risks for Ministries of Finance: An Overview*.



Third Sherpas Meeting of the Coalition

London, UK

November 18-19, 2019

Third Ministerial Meeting of the Coalition

COP25; Madrid, Spain

December 9, 2019



Fourth Sherpas Meeting of the Coalition

Abidjan, Côte d'Ivoire

February 24-26, 2020

Fourth Ministerial Meeting of the Coalition

2020 WBG/IMF Annual Meetings;
Virtual Format

October 12, 2020

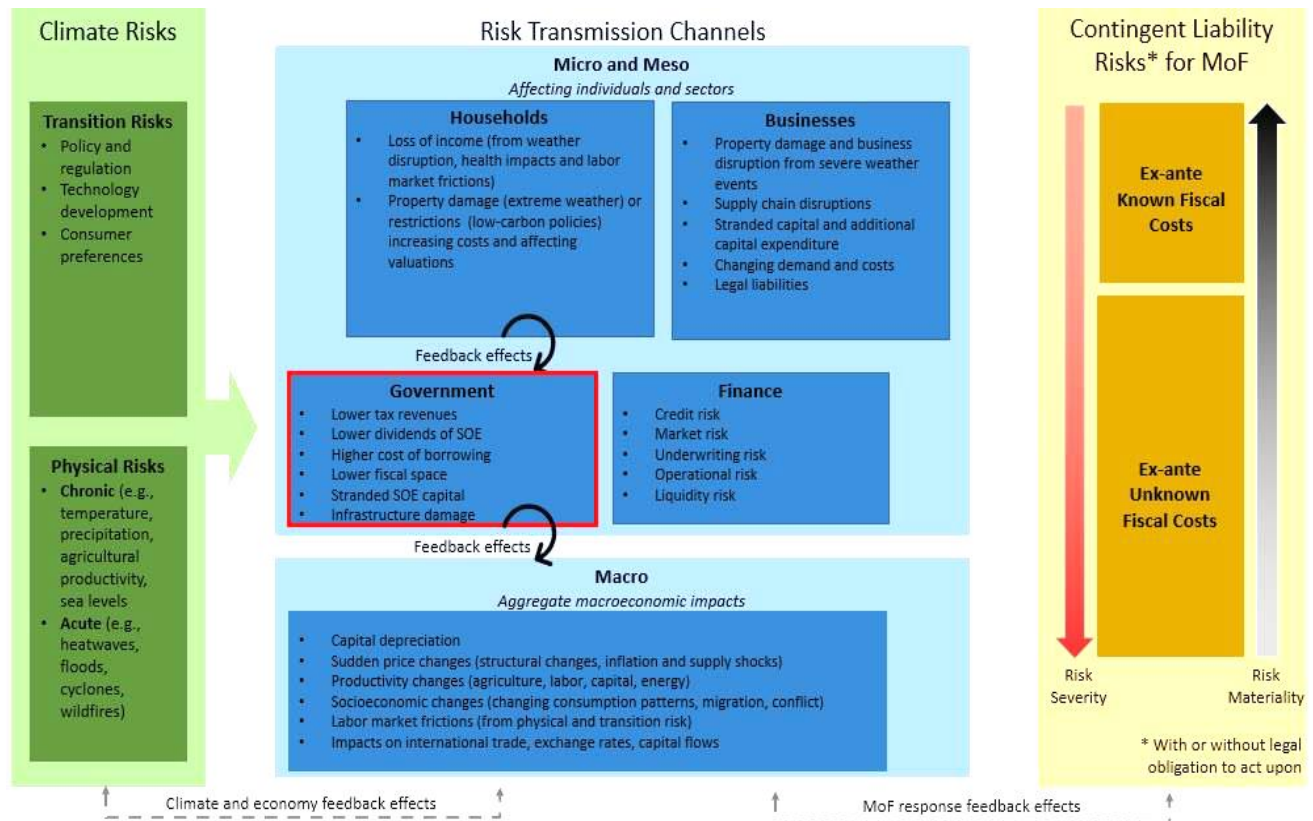


- **Sustainable finance roadmaps⁴:** Finance Ministries can lead, or contribute to, the design of sustainable finance roadmaps. These roadmaps can help prioritize actions and coordinate activities among stakeholders, including policymakers, supervisors, regulators, associations, corporations, and other financial sector participants to accelerate the transition to a sustainable financial system. Such a roadmap can be aligned with a country's long-term strategy.
- **Private financial sector Paris alignment⁵:** The Coalition and individual Finance Ministries can play an important role in encouraging the implementation of voluntary Paris alignment commitments and promoting the use of, and coordination on, climate alignment methods. Finance Ministries can facilitate the establishment of climate commitments through engaging with industry associations. Finance Ministries can raise awareness and educate relevant actors in their financial sectors on the different tools and methods that could help them align their activities with Paris goals and/or national climate objectives. Finance Ministries can then assess the Paris alignment of a country's financial system. Additionally, they have a key role to play in facilitating better data provision and the development of scenarios based on national climate milestones.
- **Green bonds, green banks, and financial instruments:** Together with Debt Management Offices (DMOs), Finance Ministries could develop public sector funding and debt management strategies that could entail risk-sharing features, such as natural disaster clauses. To finance mitigation measures, DMOs can issue sovereign green (or blue) financing instruments, which also have a market signaling role. Development finance institutions or green banks may support a green transition with innovative green financial products and concessional lending, domestically or in low-income countries. Additionally, finance ministries can play a key role in ensuring institutional conditions are in place for subnational governments to access capital markets to issue their own green debt.
- **Actions to take at the climate-nature nexus:** Finance Ministries can pursue policies that identify and manage economic and financial risks at the climate-nature nexus and mobilize private capital for investments that contribute to meeting global climate and nature-related goals and ensuring resilience to both climate change and nature loss. Accounting for the economic value of natural capital and publishing this data can help mainstream the consideration of its value in public and private financial decision making.

⁴ In November 2021, the Helsinki Principle 5 workstream published *Inputs to National Approaches – An Analysis Of Sustainable Finance Roadmaps: Charting The Path To Financial System Transformation*.

⁵ In April 2021, The Helsinki Principle 5 workstream published *Introduction to Commitments and Measurement Methods for Private Financial Sector Portfolio Alignment with the Paris Agreement, Summary for Policymakers on Private Financial Sector Paris Alignment, and Presentation of Key Findings*.

Climate-related risk transmission channels for Ministries of Finance



The Finance Ministries' expertise and tools are not sufficiently embedded yet in the design of NDCs

Nationally Determined Contributions (NDCs): The 2020 *'Ministries of Finance and Nationally Determined Contributions – Stepping Up for Climate Action'* report⁶ highlights that Ministries of Finance have a critical role in the development and implementation of NDCs to achieve low-carbon and climate-resilient development, and that Members are taking action to strengthen inter-institutional coordination, identify gaps and opportunities, and work more collaboratively overall. The report proposes mainstreaming NDCs into national public financial management systems to ensure economic and fiscal externalities of the climate agenda are factored into growth and development strategies. The mainstreaming process allows finance ministries to deploy their tools such as in the fields of annual budgeting, macroeconomic forecasts, monitoring and evaluation systems, and PFM laws and regulations to drive climate actions in a coordinated way.

The recent survey of the Helsinki Principle 6 workstream on the engagement of Finance Ministries in NDCs preparation and implementation was completed by 45 Members and provided valuable insights. When asked how the Finance Ministry contributes to NDC implementation/mainstreaming, about 76%

⁶ In July 2020 the Helsinki Principle 6 workstream published the *Ministries of Finance and Nationally Determined Contributions – Stepping Up for Climate Action* report.

responded that their Finance Ministries were working with financial institutions and line ministries to ensure climate policies were coordinated and coherent. They specified that this was done in combination with the integration of NDCs requirements into climate-informed programs and budgeting frameworks, the assessment of budget execution and climate finance monitoring, and evaluation of the quality of NDCs-related expenditures, indicating that NDCs mainstreaming is happening on many fronts.

“We have incorporated the Helsinki Principles explicitly in our budget law, putting climate change at the center of the planning and design of economic policies”

**Azucena Arbeleche, Finance
Minister of Uruguay**

Final remarks

Progress is being made on mainstreaming climate in economic and financial policies, but there is still a long way to go on this shared journey. The Coalition has stepped up efforts to mainstream climate into economic and financial policies, and will work together with institutional partners to develop expertise and analysis in support of climate action at the country level. Going forward, a special focus will be put on strengthening training and capacity building efforts, as well as identifying best practices. These efforts are expected to help translate the ‘whole of government approach’ into policy action for impact on the ground.

About the Coalition

The Coalition of Finance Ministers for Climate Action is a group of Finance Ministries that collaborate on strategies to integrate climate into economic and financial policies. The Coalition’s 65 member countries represent different geographic regions and levels of economic development, and collectively account for about 39% of global energy-related CO₂ emissions and 63% of global GDP (based on 2018 data).

www.financeministersforclimate.org