POLICY BRIEFING

TAKING ACTION IN A TIME OF UNCERTAINTY: THE ROLE OF THE G7 IN DRIVING THE ECONOMIC TRANSITION

26 April 2024

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To inform this briefing, the following investor group has been consulted: PRI Global Policy Reference Group. This consultation is not an endorsement or acknowledgement of the views expressed in this briefing.
ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system. More information: www.unpri.org

ABOUT THIS BRIEFING

The G7 Summit is an annual international forum attended by the leaders of its member states: France, the United States, the United Kingdom, Germany, Japan, Italy and Canada (in order of rotating presidency), with attending representatives from the European Union (EU). At the G7 Summit, leaders exchange views on important challenges facing the international community, such as the global economy, regional affairs and global issues. A report on the outcomes of these discussions is subsequently released. Italy will host the 2024 G7 Summit in Apulia from 13–15 June.

This briefing presents recommendations for embedding sustainability in the international policy dialogue at the 2024 G7 Summit. Previous analyses and recommendations to G7 and G20 host governments can be found here. All PRI policy research and positions can be found here.

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EXECUTIVE SUMMARY

The decisions taken by G7 countries are of fundamental importance to build an economic system that is sustainable and equitable, and that benefits both the economy and natural and social systems.

One of the key issues for all G7 countries and all world economies is how to drive effectively and enable a sustainable, inclusive transition to net-zero carbon emissions, in line with the goals of the Paris Agreement and the UN Sustainable Development Goals.

This year, Italy has set the following priorities for the Summit:

- the defence of the rules-based international system
- the relationship with developing nations and emerging economies, in particular engagement with Africa and the Indo-Pacific region
- migration
- the climate–energy nexus
- food security

This briefing summarises positions developed in response to these topics and recommends key policy reforms to support responsible investors’ efforts to address key societal challenges, in line with their investment objectives and duties.

- **The G7 and the economic transition**: Environmental and social challenges – such as climate change, biodiversity loss and extreme inequality – pose growing threats to prosperity around the world. To tackle these crises, the economic transition should be a central goal of public policy. A whole-of-government approach is needed to enable the transition, by mobilising all sectors of the economy and society at the relevant level to ensure policy effectiveness.

- **Sustainable financial regulation for the economic transition**: An integrated approach to financial regulation that does not consider sustainable finance as optional to mainstream finance but is hardwired into existing regulatory frameworks will be crucial to support a sustainable, effective transition.

- **Addressing the climate–energy nexus**: Bold, ambitious and urgent policy reforms are needed to capitalise on the economic opportunities that the net-zero transition offers. These reforms should aim to align economic activity with net-zero across all sectors of the economy to mitigate climate change, build resilience and adaptation capacity, and restore natural habitats and biodiversity.

- **Promoting the respect of fundamental rights along value chains**: To be widely accepted, the economic transition must be fair. Minimum decent work standards, aligned with the four pillars of the International Labour Organization (ILO),\(^1\) are a crucial aspect of any intervention aimed at ensuring the transition. Additionally, mandatory risk-based due diligence mechanisms can help ensure that the impacts of economic activities are actively identified and managed at an economy-wide level.

- **Ensuring food security**: The global food system is one of the main drivers of biodiversity loss. Agriculture, aquaculture, fisheries and forestry should be managed sustainably, including through increased biodiversity-friendly practices. This will contribute to the resilience and long-term efficiency and productivity of food systems. Policies should also ensure the overall fairness of this transition, aiming to manage the competing interests of various societal actors, while protecting those most affected.

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\(^1\) These include employment creation, social protection, rights at work, and social dialogue.
THE IMPORTANCE OF G7 POLICY LEADERSHIP

The climate, energy and humanitarian crises facing the world – identified by the World Economic Forum as a ‘polycrisis’ – demonstrate the importance of coordinated policy responses. Ongoing armed conflicts in Ukraine and Gaza are further heightening international tensions, with spillover effects on the global provision of food and energy. The G7 Summit is a key opportunity to tackle these crises and to set the foundation for an economic transition to a more resilient economic system. G7 countries are positioned to lead by example and have done so with policies such as:

- The Canada–Italy Roadmap for Enhanced Cooperation, which establishes plans to collaborate on priority areas, including the shift to a sustainable energy future, climate change and biodiversity, migration and sustainable economic growth.\(^3\)

- The upcoming Corporate Sustainability Due Diligence Directive in the European Union,\(^4\) which follows similar policies adopted by G7 countries such as France, Germany and Japan.

- The recent Climate Disclosure Rule adopted by the US Securities and Exchange Commission (SEC).\(^5\)

- The launch of the UK’s Transition Plans Taskforce’s disclosure framework and the Financial Conduct Authority’s Sustainability Disclosure Requirements and investment labels.

- Canada’s Fighting Against Forced Labor and Child Labor in Supply Chains Act\(^6\) and the ongoing work on the Canadian Sustainable Finance Taxonomy.\(^7\)

- Japan’s GX Transition Bonds\(^8\) and the Financial Services Agency’s mandatory sustainability reporting.\(^9\)

This briefing is the opportunity to present the PRI’s review of the host country Italy’s agenda and to reiterate the key policy reforms needed to enable an efficient economic system that benefits people and the planet.

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\(^2\) World Economic Forum (2023) We’re on the brink of a ‘polycrisis’ – how worried should we be?
\(^3\) Government of Canada and Governo Italiano (2024) Joint statement from Prime Minister Trudeau and Prime Minister Meloni
\(^4\) European Parliament (2024) First green light to new bill on firms’ impact on human rights and environment.
\(^5\) US SEC (2024) SEC adopts rules to enhance and standardize climate-related disclosures for investors.
\(^6\) Parliament of Canada (2023) An act to enact the fighting against forced labour and child labour in supply chains act and to amend the customs tariff.
\(^7\) Government of Canada (2023) Taxonomy roadmap report.
\(^8\) M MOF (2023) Climate transition bonds framework (only available in Japanese).
\(^9\) FSA (2023) 「企業内容等の開示に関する内閣府令」等の改正案に対するパブリックコメントの結果等について」.
THE G7 AND THE ECONOMIC TRANSITION

The Italian Presidency of the 2024 G7 will focus, among others, on the relationship with developing nations and emerging economies, migration, the climate–energy nexus and food security.

Public policy is critical to facilitate, enable and deliver economic and sustainability objectives. Well-designed public policies can enhance the resilience and stability of financial and economic systems by providing overarching frameworks that address externalities and manage systemic risks. Investors have been taking action to finance the transition, but there is a need for policymakers to develop an enabling environment to support this. The environmental and social challenges that pose growing threats to global prosperity mean that policymaking must no longer be undertaken in a piecemeal manner, seen simply as a matter for one arm of government, or as an issue for the public rather than the private sector. Instead, a whole-of-government approach is needed, which mobilises all sectors of the economy and society at the relevant level to ensure policy effectiveness.

KEY RECOMMENDATIONS

■ G7 governments must adopt a whole-of-government approach to transforming the economy from its current extractive and unsustainable state to one that is sustainable, equitable and beneficial to both the economy and natural and social systems. This requires:
  ■ establishing the economic transition to net zero as a central goal of public policy alongside other macro-economic factors, such as economic growth, income distribution, price stability and employment.
  ■ recognising the importance of collaboration by adopting internal governance structures that support increased coordination between ministries, departments and independent authorities.
  ■ ensuring consistency of direction (i.e. a national transition strategy) and implementation (i.e. a coherent set of policy instruments that address market externalities, build markets for solutions, enable finance for the transition and align budgets with the transition strategy).10

10 For more information, see PRI’s white paper: Investing for the economic transition – The case for whole of government policy reform.
SUSTAINABLE FINANCE REGULATION FOR THE ECONOMIC TRANSITION

Finance is central to achieving any real economy goal. The outcome of the first Global Stocktake, held at the last climate COP recognises “the role of the private sector and highlights the need to strengthen policy guidance, incentives, regulations and enabling conditions to reach the scale of investments required to achieve a global transition towards low greenhouse gas emissions and climate-resilient development”. The outcome document also encourages the Parties to “continue enhancing their enabling environment”. Adopting an integrated approach to financial policy reform will support these goals. Consequently, sustainable finance should not be treated as separate or optional to mainstream finance but should rather be hardwired into existing finance and investment regulatory frameworks.

KEY RECOMMENDATIONS

■ Enhance international collaboration and work towards global regulatory alignment to enable and support large-scale capital flows towards the economic transition, with particular attention to emerging and developing economies. This will facilitate an enabling environment for investors to drive capital towards sustainable economic activities.

■ G7 member states should continue reviewing financial regulations to ensure that they are fit for purpose in the face of sustainability-related system-level crises, such as climate change, loss of biodiversity and growing extreme inequality. Measures are needed to go beyond stress testing and disclosure, including clarifying expectations for investors to address material sustainability-related risks, strengthening stewardship and sustainability due diligence, and adapting prudential regulations.

■ Policymakers should clarify how investors can support sustainable economic growth while operating within planetary and social boundaries. Legal analysis shows that investors can pursue sustainability impact goals that contribute to the sustainability of social and environmental systems on which the economy relies while seeking financial returns. Further clarifying the definition and interpretation of investors’ duties will ensure market efficiency and prevent greenwashing and freeriding.

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11 United Nations Framework Convention on Climate Change (2023) Outcome of the first global stocktake, para 70.
12 PRI (2022) A legal framework for impact.
ADDRESSING THE CLIMATE-ENERGY NEXUS

The G7 can lead by example in the transition to a net-zero, climate-resilient economy. The ongoing war in Ukraine and growing geopolitical tensions further demonstrate that relying on fossil fuels to satisfy growing energy needs is unreliable in the long term. To ensure energy security while reducing emissions, G7 governments must implement their pledge to work to “preserve the planet by accelerating the decarbonization of our energy sector and the deployment of renewables”.13 This should be achieved through bold, ambitious and urgent policy reforms that align economic activity with net-zero across all sectors of the economy to mitigate climate change, build resilience and adapt to climate impacts. These reforms will incentivise decarbonisation, enable innovation and more effectively harness the power of capital markets in facilitating a transition to net-zero.

KEY RECOMMENDATIONS

- Implement robust carbon pricing mechanisms to incentivise cross-sectoral low-carbon innovations and increase the attractiveness of sustainable solutions. Effective carbon pricing must provide predictable price signals, minimise competitive distortions, promote international cooperation, show appropriate coverage and ambition, and enable a just transition.14

- Commit to a clear timeline and accelerate the full and equitable phaseout of all fossil fuel subsidies by all G7 members, including the elimination of all subsidies for fossil fuel exploration and production, consistent with the recommendations of the relevant international bodies, including the International Energy Agency (IEA). The energy crisis has driven a rise in fossil fuel subsidies, which must be reversed.15

- Implement the Global Pledge on Renewables and Energy Efficiency agreed at COP 2816 to triple the global installed renewable energy capacity17 and double the annual rate of energy intensity improvement by 2030. Additional efforts are needed to reduce the use of natural resources and reverse the trend of biodiversity loss by restoring natural habitats and ecosystems.
PROMOTING THE RESPECT OF FUNDAMENTAL RIGHTS ALONG VALUE CHAINS

The 2023 G7 final communique includes a commitment to “continuing to promote decent work and protect rights-holders in global supply chains through a smart mix of mandatory and voluntary measures, including through legislation, regulations, incentives and guidance for enterprises”.

Minimum decent work standards, aligned with the four ILO pillars, are a crucial part of any intervention to ensure a just economic transition, both in G7 economies and in emerging markets and developing economies.

Mandatory risk-based due diligence mechanisms can help achieve these goals by ensuring that the impacts of economic activities are actively identified and managed. This will also support a just economic transition by ensuring that the value chains of critical raw materials are free from human rights and environmental impacts.

KEY RECOMMENDATIONS

■ Adopt risk-based mandatory human rights and environmental due diligence in line with internationally recognised standards. The proportionate, risk-based approach of the recently approved EU Corporate Sustainability Due Diligence Directive (CSDDD) provides an example of how this can be embedded in policy frameworks.

■ Integrate socioeconomic considerations into any policy intervention aimed at the economic transition in line with the ILO Guidelines for a Just Transition. This should include meaningful stakeholder engagement, including Indigenous peoples.

■ Support the work of ISSB to expand its disclosure requirements to social issues, including human rights and human capital management. Corporate disclosure standards for human rights and social issues should be made applicable across sectors, geographies and business models.

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18 G7 (2023) G7 Final Communique.
19 These include employment creation, social protection, rights at work and social dialogue.
22 PRI (2023) A call for an ISSB reporting standard on human rights and social issues.
ENSURING FOOD SECURITY

Our global food system is the primary driver of biodiversity loss; agriculture alone threatens 24,000 of the 28,000 (86%) species at risk of extinction. This loss of biodiversity, including genetic diversity, poses a serious risk to global food security and the resilience of agricultural systems. The Kunming–Montreal Global Biodiversity Framework emphasises the need for sustainable management of agriculture, aquaculture, fisheries and forestry and an increase of biodiversity-friendly practices, which contribute to the resilience and long-term efficiency and productivity of food systems. The Framework also calls for the identification of incentives, including subsidies, that are harmful to biodiversity by 2025 and phase-out or reform by 2030.

Importantly, the transition in the agricultural sector must be pursued equitably. This should involve coordination between the different ministries (e.g. economy, industry, agriculture) and full engagement with affected stakeholders. It should also involve the creation of mechanisms to compensate those negatively impacted by these policies.

KEY RECOMMENDATIONS

- **Fully integrate climate and nature targets into food systems and agriculture strategies**, taking coordinated action across the climate and nature agendas to realise synergies and successfully manage trade-offs. National food systems and agriculture strategies, including any subsidies or incentives policies, should be aligned with climate and nature commitments under the Paris Agreement and Global Biodiversity Framework.

- **Support, incentivise and scale up the adoption of sustainable management of agriculture, aquaculture, fisheries and forestry**. This includes reducing pollution from nutrients and pesticides. Sustainable management contributes to biodiversity conservation and can also benefit food production systems, in terms of ecosystem services such as soil fertility, erosion control, enhanced pollination and reduced pest outbreaks.

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23 UNEP (2021) *Our global food system is the primary driver of biodiversity loss.*
25 Convention on Biological Diversity *Target 10 Enhance Biodiversity and Sustainability in Agriculture, Aquaculture, Fisheries, and Forestry.*