30th Anniversary of Banka Slovenije:
The Road Already Travelled and Contemporary Challenges

Ladies and Gentlemen, dear friends … Thank you for the invitation.

First **Covid-19**, and now war in **Ukraine**, have shaken the world's commodity chains. Shortages – and fears of shortages – are **stretching European economies**. Such system shocks echoes deeply: it's not just shipments of food and fuel, but the fertilisers and feeds at the right time in the farming cycle, and the rare metals on which the transformation of energy sector relies. In the EU, leaders are addressing the crisis with measures to improve Europe's strategic autonomy.

In **your competence area,** most developed economies, and also the Euro area, have been experiencing inflation at historical levels. As a result of a strong response of fiscal and monetary policy, the euro area economy has recovered strongly from the pandemic shock. In contrast to the response during the euro area sovereign debt crisis, governments have provided coordinated and unprecedented support for the economy. However, this has led debt levels to increase further and the Governing Council of the ECB have already been reviewing its monetary policy strategy.

While it is paramount that we address the serious knock-on effects of the crisis, we **cannot afford to discontinue our sustainability efforts**. We can no longer ignore how fragile our economies and societies are, and how important it is to increase their resilience. Prescribing pain killers and trying to remove merely the short-term pain will not heal the disease, and the next crisis will find us soon again and still searching in panic for ad-hoc solutions.

When everything seems to be running well, food and energy security or monetary stability are taken for granted. **But food security** is not a stockpiling mentality, or an intensification of input and production. It is about changing how much we produce for direct human consumption rather than animal feed. It is about upscaling systems like agroforestry, which simultaneously provide food and beneficial ecosystem services. It is about technologies: precision agriculture, vertical farming, and meat alternatives. It is about food waste - and the equally unethical waste of land, energy, and pesticides on uneaten food. It is about health of our pollinators and soil. Food security is also about broader policies: the proportion of food crops and soils used to produce biofuels; the extent of fertile land being swallowed by expanding cities or resource consuming inefficient transport systems.

Likewise, **energy security** does not mean replacing one source of fossil fuel with another or from another region. It is not even primarily about providing abundant and affordable renewable energy. Beyond producing cleaner, lower-energy steel, we need to look at how much steel we use in our terribly under-utilised cars. It is about shared-mobility alternatives to cars, and better-designed cities that minimise our must-make journeys in the first place. It is about how efficient our homes are built and the amount of space we use for our living needs. It is about behavioural choices, such as working from home; and when we're there, how well the products we consume - their lifetime, upgradability, reparability, and recyclability - supports us in those choices. It is about energy used to produce the clothing we are wearing or, even worse, not wearing.

And as you know better than me, **monetary stability** is not only about immediate needs to supervise and control the inflation pressures, but it is also about all the challenges you face due to financial sector aspiration for higher profits, and in a role, you must play to help the needed transformation of our real economy.

This multiple approach may seem a long way from the economic counter-offensive - the single, swift response - that political and media logic demands. But it is less strange to those working to hold back the underlying planetary crisis. Here, the cumulative effect of many positive, system-changing decisions is almost the only thing keeping a stable and safe world within reach. While dealing with acute challenges, we are also facing an **emerging chronical and systemic environmental and social crisis** due to the overuse of natural resources and uneven and unfair distribution of their benefits. The triple planetary crisis (climate, biodiversity, and pollution) is making **instability the norm**.

Natural resources are at the heart of our environmental and human health challenges. The use of materials - fossil fuels, metals, minerals, biomass, everything we extract from the Earth - has tripled since 1970 and accounts for a huge share of greenhouse gas emissions. In overusing Earth's resources, and by distributing the benefits unfairly, our economic model is taking far more than the planet can sustainably give.

In recent decades, resource use has significantly improved living standards and wellbeing in many parts of the world, but this now comes at an unprecedented cost to climate, environment, and health. The problem is that humankind has **never separated out economic growth from ever-rising demand for resources.** As a result, we are now overstepping planetary boundaries, and locking ourselves out of the safe operating space in which human societies evolved.

We must instead **link resource use to fundamental human needs and optimize the systems that deliver them**. We do not need a car, we need mobility, we do not need a chair, we need to sit comfortably, we do not need a fridge, we need fresh, healthy food. So much extracted material goes into under-utilised cars, inefficiently built cities, and poorly maintained machinery. If we look at our production and consumption through the lens of natural resource use, we can start to look at the transformation of the whole system, not just of a specific sector. We need to reject the assumption that these systems need to be so resource intensive.

As a university student, I was taught that **economic theory** is based on the rational behaviour of consumers and producers: the more we produce at the lowest possible price, the higher the capital returns and GDP growth. But what if the whole economic system was at fault? Undervalued human capital and, in many cases, not valued natural capital by our markets, are leading to systemic social and environmental imbalances. Imagine that for example, **Mercator customer**, would enter the food shopping centre and not pay, at least not pay the full price, for the things taken home

... Mercator would soon get bankrupt. The same is happening to nature. Nature is a large eco-system getting bankrupt due to our behaviour. Our short-term rational behaviour is leading to a long-term irrational "charming mass suicide" as Arto Paasilinna titled one of his excellent novels.

Our international efforts to fight the climate crisis remain **focused on, and driven by, the supply side.** This, the recent IPCC report[1] warns, will fail to limit warming to 1.5C. But authors add that demand-side mitigation could reduce global GHGs in some sectors by up to 70% by 2050.

More fundamentally, demand-side measures get us closer to the **human questions of responsibility and equity**. High-income regions, including Europe, must take the lead. Resource efficiency should thus be complemented with sufficiency-based policies.

Until then, ambitious policies such as the EU's Green Deal and the UNFCCC's targets face an **uphill battle** to implement incentives and regulations to change our production and consumption patterns. Sending policy signals one way, and market signals the other, is creating confusion (not to mention intense lobbying by companies that fear the loss of profitable markets). It's time to stop signalling to producers that destroying natural capital is free of charge. Time to stop contradictory messages to consumers, who still routinely pay more for food with a low environmental impact, instead of the reverse.

Dear friends, we are in an **unprecedented time,** on many levels. While challenging, this is also a great opportunity to create positive lock-ins for more resilient, fairer, and healthier economic models, for both people and planet. The **European Green Deal** is clear in its vision and ambition, aiming not only to reach net-zero emissions, but also to decouple economic growth and human wellbeing from emissions and resource use. While decreasing inequality, it aims leaving no one behind. This is EU's new 'growth strategy' rather than the new environmental and climate package, mainstreaming sustainability across all policy areas.

This gives a clear message also to **private banks and European public financial institutions** encouraging them to redefine priorities and offering stability to sustainable investors. Economic activity depends on investment; therefore, **investors have enormous power** to determine the type of economic activity taking place. Currently, financial flows towards natural assets and sustainable economic activities are still dwarfed by financial flows which harm nature and contribute to climate change. Clearly, this balance needs to shift, and the direction is clear as pointed also by **Larry Fink, Chairman and CEO of BlackRock in January this year**, "The next 1,000 unicorns won't be search engines or social media companies, they'll be sustainable, scalable innovators – start-ups that help the world decarbonize and make the energy transition affordable for all consumers."

[1] Climate Change 2022, Impacts, Adaptation and Vulnerability, 2022

Private investors often avoid greening portfolios, investing in opportunities like those highlighted above, stating that they have a duty to maximize short term return for their shareholders rather than to contribute to societal goals more broadly. It is not yet widely recognised that financial activity which serves the wellbeing of people – including the wellbeing of our planet – is what will ultimately drive sustainable returns for shareholders through providing long-term consistency and stability. What is needed is a better alignment **of short-term optimisation with longer-term needs.** It is not only the fiduciary duty of investors to act now to protect client assets, but there is also a ripe opportunity for the finance sector to champion sustainability leadership and shift the entire economy in a safer direction, which will best protect clients and ripe opportunity. Private investors have a crucial role in greening their portfolios through supporting innovative opportunities, but they are acting within a regulatory framework, which incentivises concentrated profit maximisation and does not always recognise environmental risk.

Which leads me to the role of regulators of the whole financial system, to the Central Banks. Thanks to your key roles in maintaining price stability and consumer confidence, and setting direction for private finance, central banks are privileged and uniquely positioned to facilitate this transition. Central banks are publicly owned institutions, whose mandates are set by their governments. So, you should reflect the long-term interests of the societies you serve.

Central banks influence the economy in two major ways: monetary policy and financial regulation. **Monetary policy** aims to control price stability, preventing massive inflation or deflation. This involves adjusting interest rates and buying and selling financial assets, like government bonds. And all that have a huge direct impact also on consumption and ultimately, it is linked to increased natural resource use. **Financial regulation** is another Central banks' major responsibility: micro-prudential, regulating individual financial institutions; and macroprudential, regulating the financial system. Macroprudential policy empowers central banks to maintain stability, preventing bubbles and economic shocks. You have a crucial role in setting the direction for private finance, determining how markets act, forcing markets to recognise and respond to real risks. The **topic of natural resource management** however is one that is not widely understood, and thus a key next step is in **understanding nature-related physical, transition and liability risks**. Given the stability focus being central banks' main aim, financing sustainable natural resource use should be a primary objective.

You have the **capacity to change your mandates** to cope with the most pressing challenges of the day. Some are already updating mandates to reflect central banks' role in combatting climate change and nature destruction. European Central Bank (ECB) has, for example, drawn up an ambitious climate action plan. Though it is an extremely encouraging signal, the ECB's climate action plan has received criticism for being too vague to effectively prevent financial flows to big fossil fuel users.

Central banks have been also conducting **research and analyses to better understand the climate risks commercial banks face**. For instance, more than 50 central banks have banded together to form the 'Network for Greening the Financial System' (NGFS), which recently published climate scenarios to stress test the system. Building on this, the ECB and French Central Bank jointly conducted another economy-wide stress test and concluded that "**there are clear benefits in acting early. The short-term costs of the transition pale in comparison to the costs of unfettered climate change in the medium to long term**". The recent IPCC report is also clear "Containing warming to 2 degrees C would require actions that limit global economic growth by 1.3% to 2.7% by 2050. However, that loss would likely be outweighed by the overall economic benefit of limiting warming." Question more and more resonating among many is: How much **growth maximisation measured in GDP is still correlated with increasing wellbeing,** in particular in high and upper middle-income countries – the very countries who consume the most resources per person? We need to **rethink the north star leading our behaviour and our policies.**

What would need to be the **next steps linked to financial sector?** To encourage central banks, and the governments who determine their mandates, to fundamentally embed action on sustainable natural resource use, **we need to ask the right questions** of their next steps. Their overall objective is economic and societal stability; given the triple planetary crisis, this must mean responding to climate change and nature destruction. For monetary policy, can central banks go beyond their current commitments to prioritize investment which stimulates sustainable resource use? On the financial regulation side, can central banks make it a mandatory requirement for all financial institutions to publish credible transition plans aligned with the Paris and Glasgow goals and planetary boundaries? Can emission heavy investments be defined as too risky to be viable?

As mentioned, the financial system and the real economy are deeply connected, and dependent on one another. It is in the financial system's interests to operate in a manner which supports and protects our planet, while contributing to societal goals, ultimately supporting societal wellbeing and stability – which means ending support to unsustainable natural resource use. Real system change will require a broader conception of what value is. **Mark Carney**, ex-Governor of the Bank of England, discusses this in his 2021 book 'Value(s)'. He argues that market values, and an overreliance on market forces by governments and regulators, have led to a society that is unable to express what is important to it. He suggests seven key values – solidarity, fairness, responsibility, reliance, sustainability, dynamism, and humility – which lead to three elements of a good society: fairness between generations, income distributions, and life chances. He argues that governments who most overlooked these values were the least prepared for Covid-19, and that they are making the same mistake with climate change.

As you know Mark Carney also unveiled the **Glasgow Financial Alliance for Net Zero** last April during the climate convention. In commenting developments since COP26 he agrees that Russia's invasion has hampered the pace of decarbonization, "because it will use up more of the carbon budget." But in the longer term, he insists, the war is convincing governments of the need to create energy security with domestic and renewable resources. He listed also very concrete recommendations that will emerge from the Alliance in June, around five pillars: how companies can create practical climate transition plans; how the financial sector can support a managed phaseout of high-emitting assets; how finance can find effective pathways for sectors such as steel, transport and agriculture, and measure progress there; how to tackle problems with the quality and availability of data; and finally, how financial groups can align their portfolios with net zero.

There is already a high level of agreement that a transition to a more sustainable society and economy has no reasonable alternative, but ultimately, it will be about the **speed and scale of the transition**. It will be about addressing key drivers and pressures that cause the challenges we are facing, about providing systemic perspective to guide decision-making, and about channelling sufficient investments aligned with recovery needs to support the transition. Financial sector, central banks in particular, are playing, and will play a central role, also in the future. What is needed now from central bank strategies is greater precision on how their action on the planetary crisis and its drivers can have maximum impact.

To conclude.

Making our fragile economies and societies more sustainable and resilient is our best defence against any future crises. In the longer term, food and energy security or monetary stability are not about opening a new economic front. They are, first of all, about **reassessing our values, rethinking our economies and reducing overconsumption**. Standards and behaviour patterns linked to the current economic model were set by high-income countries. We are ethically bound to show the world that we are willing and able to change a reality we created, and to lead the essential transition – at home and globally.

The map of **resource use still shows the shadows of an imperialist world,** where wealthy nations pursue their ambitions at the expense of others. A more stable and sustainably prosperous future will mean shifting to an era of responsible resource use, where benefits are more fairly shared, mitigating resource fragility and strengthening our preparedness and resilience. The more we avoid these strategic, sometimes difficult decisions, the more likely is that that we will soon face them again. For **The Future We Want** we need a **system-based approach**: minimising trade-offs and future lock-ins and maximising co-benefits and synergies among all our efforts. Focusing only on cleaning the current production systems will unfortunately not be enough. We must enter the untapped territories of the needed deep system transformation. If we want to avoid extinction of elephants in nature, we need to extinct elephants in the rooms.

According to the **Dasgupta Review,** our unsustainable engagement with Nature can be traced to institutional failure and the failure of contemporary economics to acknowledge that we humans are embedded within Nature, and not external to it. So, for the beginning, it would be good to agree that **humans are part of nature** and start behaving accordingly.

And this should be **acknowledged not only by all the governments, but also by the financial system and by the central banks**. Limiting attention of central banks to a rather narrow monetary related questions would be just a sign that you underestimate the importance of your role and also underestimate your responsibility in addressing the challenges we collectively face as a globalised economy and interdependent society.

My sincere **congratulations to the Bank of Slovenia for the 30th anniversary**, good luck with your demanding tasks and thank you for your attention.

Janez Potočnik May, 11th 2022