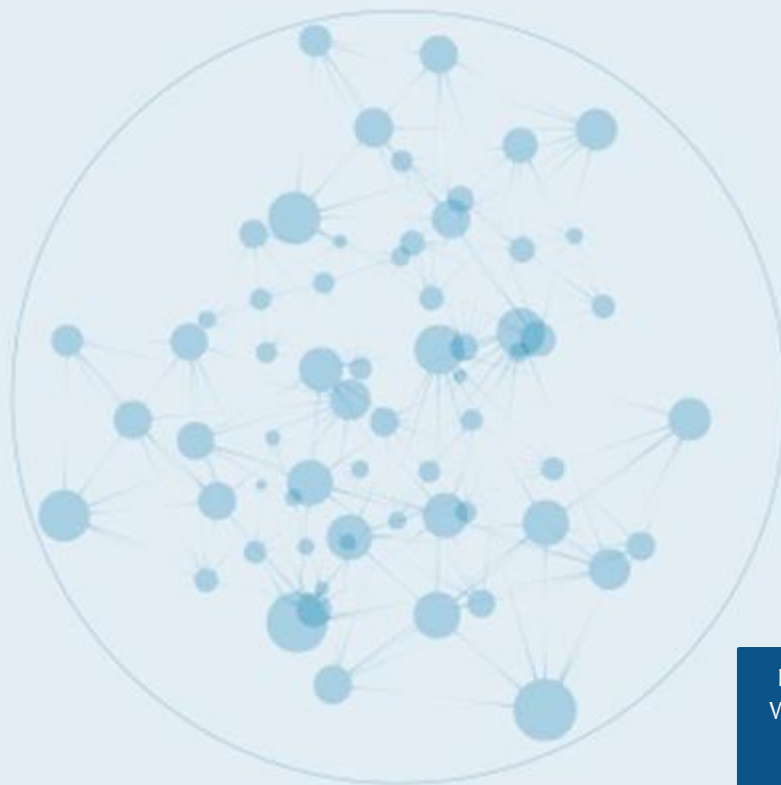




MAKING THE JUMP

How Crises Affect Policy
Consensus and Can Trigger
Paradigm Shift



INQUIRY
WORKING
PAPER

16/04

February
2016

The UNEP Inquiry

The Inquiry into the Design of a Sustainable Financial System has been initiated by the United Nations Environment Programme to advance policy options to improve the financial system's effectiveness in mobilizing capital towards a green and inclusive economy—in other words, sustainable development. Established in January 2014, it published its final report, *The Financial System We Need*, in October 2015.

More information on the Inquiry is at: www.unep.org/inquiry or from: Ms. Mahenau Agha, Director of Outreach mahenau.gha@unep.org.

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About this report

This paper draws on material from 34 anonymized interviews with principals who were present during the financial crisis, and who were active in the international institutional and policy response that it triggered.

It results from a workshop the UNEP Inquiry and CIGI held on 2-3 December 2014 in Waterloo, Canada to discuss options for a sustainable global financial system. The workshop included participants from a range of academic and research institutions from the Waterloo region and abroad, including the University of Waterloo, the University of London, Harvard University, and the University of Gothenburg.

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Introduction

The scientific worldview undergoes relatively rare paradigm shifts (Kuhn, 1962), such as the move from the Aristotelean, geocentric view to the Copernican, heliocentric view in 1543. Such major shifts can also occur in the economic, financial, or regulatory world view that is dominant in a particular era. Economic events, and in particular severe national (Gamble, 1988; Hall, 1993) or global crises, can cause an increase in anomalies that cannot be explained by the current consensus. Eventually, a tipping point is reached, which signals the beginning of a paradigm shift in world view among leaders, expert communities, and in the policies they adopt and champion. This type of shift is what has occurred since the 2007-2008 financial crisis and in the response it engendered.

The dynamics of paradigm shift and rapid policy evolution

This paper outlines the dynamics behind the financial regulatory paradigm shift that began in 2008-2009. It seeks to identify parallels with and differences from the slower moving, even more consequential, global climate change crisis, and the fitful, still under way, policy paradigm shift that the United Nations Environment Programme (UNEP) and other stakeholders are trying to support and facilitate linking economic sustainability, financial regulation, markets, and climate change. The following ten observations are developed in this paper:

1. Crises matter for financial system design and reform
2. Crises can enable leaps from one policy narrative to another
3. The abandonment of prior policy norms is possible
4. Not all policies are equally strong within a paradigm shift
5. Dominant expert communities matter to paradigm shifts and policy outcomes
6. The creation of policy consensus between communities also matters
7. Paradigm shift is not a smooth process, but a lumpy one
8. Using soft-law mechanisms is a viable second option
9. There are multiple pressure points for change
10. Emerging countries are important to the paradigm shift.

Some of the lessons from the financial crisis response and policy shift are potentially useful and positive. Others are more mixed. Some are negative. Nonetheless, these observations from the financial crisis have utility as policymakers and actors consider how to impact the speed at which broad new policy approaches can be adopted, and can begin to integrate climate change risks within financial decision-making and policies.

The pre-crisis period

The period leading up to a paradigm shift sees increasing anomalies, observations, and events that cannot be explained with an existing model. Proponents of the model defend the status quo, but ultimately, either suddenly or eventually, the consensus shifts in favour of a new model or theory.

A tipping point and shift in world view was seen in response to the financial and economic crisis of 2007-2008. Initially, there was denial or a refusal to see what was unfolding. This rapidly transitioned into a realization among an increasing number of actors that the neoliberal economic and regulatory models had failed. The totemic myths of self-correcting, self-stabilizing markets, based on rational actors and decision-makers, were exposed as naïve and false. The great moderation was over. Credit and trade had

ground to a halt. Panic was endemic. The US and other economies rapidly contracted. Trillions of dollars in assets, in both housing and personal wealth, were wiped out. Action was needed to arrest the crisis.

Collective state action—a reassertion of state power and authority—was the only remaining option. Policymakers confronted “the limits of unrestricted globalization [and] ... the intrinsic tension between global financial markets and sovereign states” (Subaachi, 2010). Leaders were faced “not only with the collapse of a financial system, but also with the collapse of a worldview” (Ferguson *et al.*, 2010). Laissez-faire neoliberalism confronted a legitimacy crisis (Chorev and Babb, 2009; Helleiner, 2010), and the spell of the “mystical Anglo-Saxon model of liberalization and deregulation” was broken (El-Erian, 2009). Pressed by the nature of the crisis, a change in the paradigm of regulatory and economic governance began (Constancio, 2010).

In the case of climate change we may be (finally) nearing the end of a long drawn-out pre-crisis period characterized by increasing anomalies, severe and inexplicable – at least to certain sections of the political elite in key countries – climate events and long-term trends. The consensus has shifted inside some communities. But it has yet to do so within other communities that are central to tipping the policy narrative from resistance to a new mindset and ideational worldview. When that occurs, the paradigm and narrative will shift faster and can strengthen and solidify.

1 Crises matter for financial system design and reform

Crises matter for financial system design and reform. When all parties face disaster, new narratives can emerge to guide policy. Petty national differences dissipate. Issues are clarified. The menu of possible solutions enlarges. Domestic interests are quiescent. Decision-making is hastened.

The 2007-2008 crisis created dynamics that helped clarify issues, highlighted failures, forced actors together, allowed consideration of a broader array of policy options that would otherwise be ruled out, and provided a window of opportunity that permitted major policy shifts that, absent a crisis, would be considered highly unlikely or impossible to achieve. There is also a rhythm to crisis response. First, we see immediate crisis management—the firefighting phase. Then, there is an effort to identify the reasons for the crisis and design reforms: the concrete reform phase. Finally, there is a return to business based on the “new normal.” As this happens, dissension reappears and the centripetal forces of the crisis are replaced by centrifugal forces of normal international diplomacy. This cycle of crisis management, reform, and gradual relapse is seen in the financial crisis.

In the financial crisis response, we are well into phase three: a gradual return to a new normal based on the altered policy consensus. In the climate change response we are still in a prolonged firefighting phase, and perhaps at the start of the reform phase. But matters are much more complicated and the policy consensus is weak or lacking among key constituencies, in the economic and financial sectors, and certain key governmental ministries. So the coalescence of a new climate change paradigm is still being disputed.

2 Crises can enable leaps from one policy narrative to another

Facing crises, policymakers can leap from one theory to another if the prior beliefs prove incapable of explaining anomalies, and fail to provide a solid basis for future financial sustainability and stability.

The economic and financial crisis of 2007-2008 precipitated a collective jump among political leaders, especially among their experts in the central banking community. The crisis caused political leaders and policymakers to make a pronounced shift away from the previously dominant neoliberal laissez-faire “market fundamentalist” (Stiglitz, 2008) viewpoint, towards the collective reassertion of state power (Padoa-Schioppa, 2010), made actual through the reregulation of global financial markets and firms, using new forums and institutions (principally the G20 Leaders’ Summits and the Financial Stability Board [FSB]). The paradigm shift in regulatory worldview that began as a result of this narrative shift is not yet complete; it is the subject of dispute, and defence; it is stronger in some areas than in others. But the shift constitutes a significant and potentially durable new worldview.

Senior political leaders and officials present during the crisis response use similar language. They speak of having no alternative, of needing to act, of looking into the abyss, of needing to step back. Participants identified a “real convergence,” and describe it as the formulation of a “new consensus” by various sources (Blanchard *et al.*, 2012; Constancio, 2010; Smaghi, 2008).

The 2007-2008 crisis demonstrated that the creation of a new policy consensus can be quite rapid—a sudden shift in stance precipitated by a crisis and a common consensus about its causes and possible solutions. Alternatively, the build-up of anomalies, crises, and the process of paradigm shift and consensus creation may be a multi-year exercise in deliberation and dispute. In other words, changing the policy consensus can be fast or slow.

The financial and economic crisis was clearly visible, as were the obvious policy failings. The crisis had widespread and immediate effects globally that resulted in public demands for swift action. The financial crisis also had antecedents in the more minor financial crises of the 1990s and 2000s. Not all central bankers had left Galbraith (1954), Kindleberger (1986), or Minsky (2008) mouldering on their bookshelves, although many did. Former Fed Chairman Ben Bernanke, in particular, was acutely aware of the lessons from 1929, the parallels, and the need to act, and what he believed those actions should be. Other policymakers made rapid U-turns, such as Mervyn King, former Governor of the Bank of England and Chairman of its Monetary Policy Committee. Still others, such as Adair Turner, former Chairman of the Financial Services Authority, led the post-crisis dissection, self-analysis, and policy response. Policymakers had models to reach for and could check and compare their responses to other historical events.

This is not the case for the major—arguably even more important—climate change crisis confronting global political leaders and financial policymaking communities. The wave of the crisis in this case is higher, broader, and envelops us all. Because of this, it is harder to grasp and see as individuals, policymakers, and political leaders, since there is a natural tendency to focus repeatedly on the more immediate troubles rather than something ongoing, amorphous, and difficult to fully grasp. The sense of imminent crisis is less keenly felt. From a policymaking standpoint, climate change is more intractable. The costs are higher but more diffuse. The timetable for action is both urgent and yet distant. And the tragedy of the commons can result in delayed action by individual actors and states.

The climate change crisis also has a frequency of one. That is, no one in human memory has experienced what is today under way. It is therefore potentially harder to shift the public consensus and policymaking communities to the tipping point of a new consensus, because of the lack of evidentiary parallels outside those understood by scientists looking closely at ice cores, which capture events on geological timescales. Shifting the public and policymaking consensus permanently to one that more fully captures the environmental and societal risks, which are already unfolding, is a huge task.

But once the tipping point is reached within the consensus narratives used by key policymaking communities that control economic and financial policy levers, significant rapid change should be possible and faster than perhaps looks possible before a paradigm shift is triggered.

3 The abandonment of prior policy norms is possible

In crisis-altered circumstances, what are considered “settled agreed norms” can suddenly be jettisoned by political leadership and a policy community in favour of a new narrative, a new perspective, and a new set of policy tools.

In the financial crisis, we saw the rapid design and agreement of a new, quantifiably stronger approach to the coordinated macroprudential supervision and regulation of global financial markets, and firms emerged rapidly out of the crisis response.

The approach “seeks to develop, oversee, and deliver appropriate policy response to the financial system as a whole rather than focusing on individual institutions or certain economic measures in isolation. Macroprudential policy aims to enhance the resilience of the financial system and to dampen systemic risks that spread through the financial system” (Group of Thirty, 2010). This policy shift signals a major narrative and policy change in the central banking supervisory approach of developed countries (it had been used in China and Japan previously), from one predominantly focused on the stability of *individual* institutions (microprudential oversight) towards a focus on the stability of the financial system *as a whole*. Post-crisis, the central banking community consensus swiftly adopted this macroprudential policy

viewpoint. The FSB, and the Basel Committee on Banking Supervision below it, designed and agreed macroprudential tools that would be applied consistently throughout the economic cycle (such as higher capital, liquidity, and leverage standards), and variable tools that could be triggered during the cycle as asset bubbles begin to develop (such as countercyclical buffers). The policy is a multifaceted reregulatory stance and series of interlinked policy solutions. It is a rejection of the past neoliberal laissez-faire approach to financial markets, firms, and adds the maintenance of financial stability explicitly to collectively applied central bank goals.

The Basel III Accord is the keystone of this policy worldview. Agreed in little more than a year from 2009 to 2010, it increased by an order of magnitude the level of core equity and risk-adjusted capital to approximately 10 per cent, required by the world's largest and most systemically important firms. This accord was and is the central policy element in the new approach.

The strength of the accord is being further buttressed with a 2014 proposal to increase risk-adjusted capital for the world's largest banks even further, through the adoption of a new measure, Total Loss Absorbing Capital (TLAC), which would require the largest firms to hold up to 20 per cent risk-adjusted capital. Both this new measure and national actions underscore that the new normal is not static but is still being built and strengthened.

National Basel-plus “gold plating” is seen in major jurisdictions. This, and the proposed TLAC, are important leading indicators of the robustness of the underlying new normal. They demonstrate that the paradigm is progressively improved and added to rather than weakening. The paradigm of progressive improvement is what one would expect of a paradigm becoming more durable—incremental additions to the new normal.

To conclude, central bankers abandoned prior positions and adopted a new macroprudential consensus in response to the global financial crisis. The community then applied this worldview to banking supervision resulting in a large material increase in coordinated regulation and required capital for the world's largest financial institutions. Basel III, its application and national implementation, indicates the strengthening of the new worldview during the last six years, signalling a reassertion of state power and authority over financial markets and firms. Just such a shift in the policy consensus is also possible (but not certain) in the climate change space.

4 Not all policies are equally strong within a paradigm shift

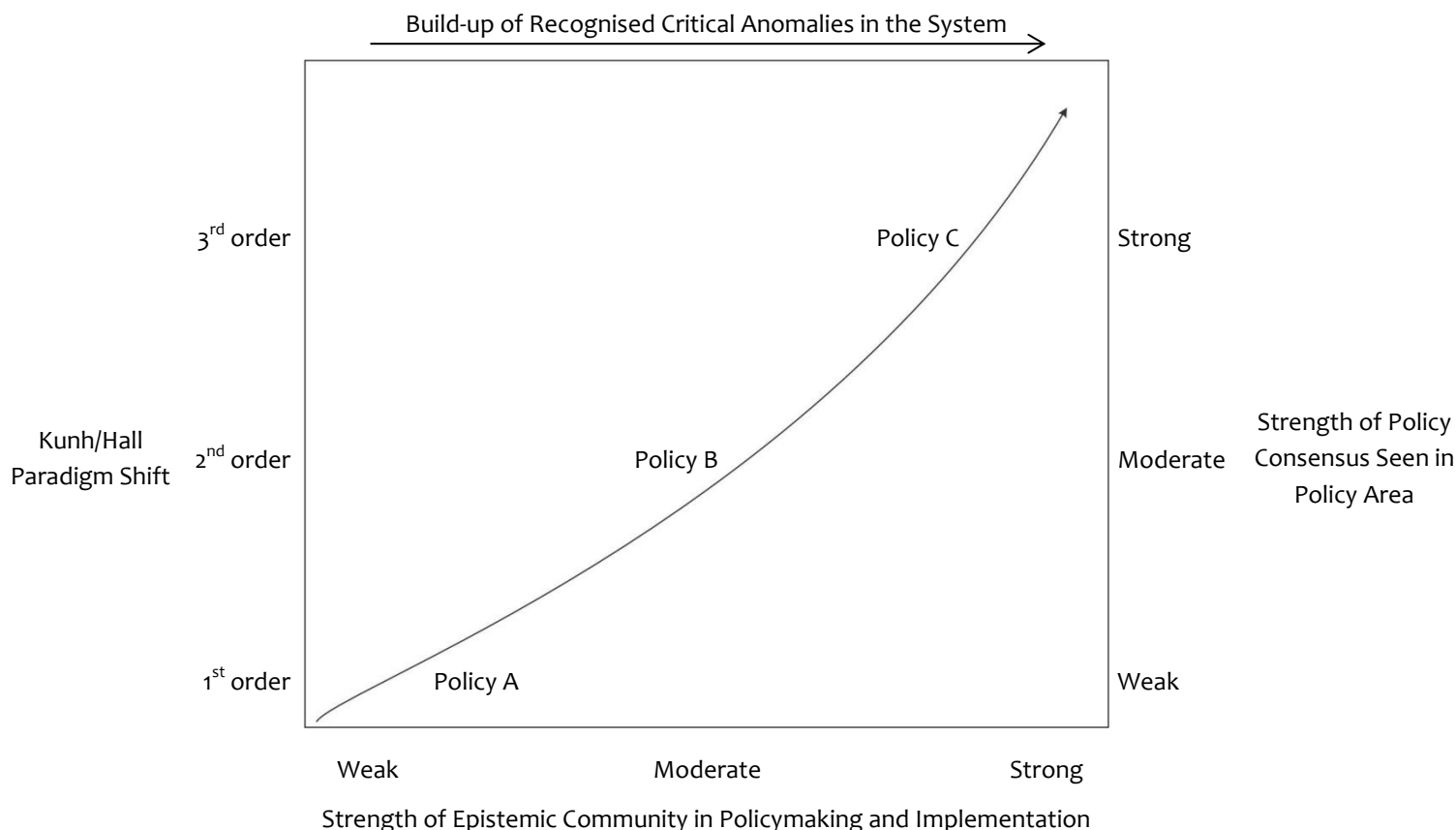
In any new worldview, not all policies are equally strong. But this is to be expected. Some are large jumps (such as macroprudential policy), others are less momentous, but still additive to the new policy architecture. The history of the G20 and its regulatory reform agenda indicates that a paradigm shift began in 2008, picked up momentum in 2009, and continued, albeit more slowly and incrementally, from 2010 and through 2016. Some policy changes are strong, others less so. But, contrary to Moschella and Tsingou's position, you cannot achieve paradigm shift by incrementalism alone; there must be a jump—a real break—with the past policy worldview (2013).

The changes in policy fall within the first-, second-, and third-order changes identified by Peter Hall of Harvard University (1993). First-order changes are forms of normal policymaking, “a process that adjusts policy without challenging the overall terms of a given policy paradigm” (Hall, 1993). Second-order changes are moderately more significant where the instrument of a policy is adjusted but not the overarching policy. Both first- and second-order changes are characterized by incrementalism. Third-order changes reflect radical changes to the overarching terms of the discourse and indicate a paradigm

shift occurring. They involve the accumulation of anomalies, experimentation, failures, and a reappraisal of existing truths. The process is likely to be contested. An intensification of debate about economic issues occurs. Issues of authority and power are central. Third-order change, the paradigm shift described by Kuhn (1962) in the scientific world and Hall (1993) in the economic context, is a major reappraisal—an event at least an order of magnitude greater than first- and second-order changes.

Figure 1 graphically represents the dynamic interaction between the extent of the crisis and anomalies, the strength of the policy consensus, and the control over the policy levers of the epistemic community in charge (Haas, 1992), and type of shift in policy seen.

Figure 1: The Central Banking Community, Policy Consensus and Paradigm Shift



Source: Mackintosh (2015)

In *Policy A*, the number of collectively recognized anomalies is small. The epistemic community is weak in the policy space. The resulting policy consensus is also weak and the results are first-order changes. The combination of these factors (too few anomalies, a weak or conflicted policy community, and a weak consensus) produces poor policy outcomes.

In *Policy B*, a greater number of anomalies are recognized. The community is stronger in the policy space. The policy consensus is more robust. The resulting policy outcome can therefore be stronger and of second-order magnitude.

In *Policy C*, huge anomalies are present and are recognized by a majority of the community and actors. A community is in control of policy. A strong new policy consensus is agreed. The community has power and influence in the policy space. This results in a third-order, paradigm shift.

This graphic conceptualization also illustrates that not all crises lead to paradigm shift. A combination of factors must be present to trigger the necessary third-order changes that constitute a paradigm shift. Arguably, the lack of these key interrelated factors in the climate change space has resulted in weaker, and often unsatisfactory, policy outcomes.

5 Dominant expert communities matter to paradigm shifts and policy outcomes

Figure 1 underscores that expert communities, and in particular the dominant expert community, is important to policy outcomes. In the financial crisis response, the central banking community played the leading role in supporting and facilitating the reregulatory shift. The central bankers conceptualized the new policy narrative and the reassertion of state authority over markets; they advised the political leaders at G20 summits on the financial redesign; they fashioned the policy framework and the key macroprudential “solution”; they led the implementation via the FSB, which they dominated and financed. And this same small, elite group had the regulatory power to implement policies they agreed as a community. In summary, the role of the central banking community, and within that of a small group of leading figures, must be underscored. This community with a new worldview is today continuing to construct the new regulatory normal, to defend its creation and to ensure its viability; they are better able to do so because they have a consensus narrative that helps them frame their goals and defend their creations. What was constructed at the level immediately below the G20 was a policy “consensus amongst the elite that operates, in the first instance, above the fray of domestic politics” (Bennett, 1991).

6 The creation of policy consensus between communities also matters

In the financial crisis, there was a high degree of synchronicity between G20 leaders and the expert community of central bankers in the immediate crisis response and reform phases of the response. This coincidence of narratives and policy goals is much less evident in the environmental policy space. Indeed, larger gaps are seen in community worldview and narratives, and in policymaking leverage.

There is no doubt that the scientific community has made the jump to a new, now dominant, consensus on climate change. Today, practically all scientists in the field recognize climate change, and the community has adopted a consensus view on its importance and the need to act, and act fast, to adjust national policies and models to integrate proven scientific conclusions within the policy responses into other areas of human endeavour.

But in the case of climate change, the community of experts has less control over the levers of respective national policy processes. Climate scientists operate as the key expert technical community, but they do not hold the economic or regulatory policy levers determining the actual regulatory responses. In most cases they are at arm’s length from that process—one that is highly susceptible to domestic political jockeying, and to pressures that work against common goals.

To put it bluntly, the new climate change paradigm and narrative within which scientists live and work still must be more fully adopted and internalized within the communities that control the international and national policy levers, including the economic and finance ministries, and central banks. This must take place for policy shift to occur. If the necessary narrative overlap and consensus is lacking there are too few Putnam-type “win spaces” (1988) for progress to be easily achieved.

Greater concentration on how to bridge this gap in understanding between those already inside the new consensus and those still confused and holding to the failed older worldview is required. It may be that some of those in the financial sector are actively opposed to the new paradigm the UNEP seeks to

support. There are others who will resist change simply because it is outside their own community knowledge and consensus. But it may also be that some financial actors and regulators do not understand the ramifications. The latter two groups can be persuaded to alter positions with compelling evidence relevant to their communities and roles.

7 Paradigm shift is not a smooth process, but a lumpy one

In the financial crisis paradigm shift we see “lumpy” results. As already observed, third-order change is seen in the adoption of macroprudential policy mechanisms and tools. The creation of the FSB is also a third-order change in the form (the degree of institutionalization); the qualitative nature (the seniority of and commitment of the principals to the agreed processes); and the quantitative level of coordinated international regulatory cooperation and implementation (the number of, and multilayered, multifaceted nature of the processes and reform agenda).

From its birth until 2014, the FSB has been primarily led by allies of the central bankers most invested in the shift underway, such as Mario Draghi, Mark Carney and their allies. Crucially, the FSB central banking community controlled many (but not all) of the policy levers needed to force the changes they collectively agreed to. As independent central banks and regulators, this expert community, once it agreed the contours of the “new normal” and secured the political backing for the shift, could proceed to implement the changes. In this crisis and paradigm shift, the G20 leaders and the expert community that oversaw the reforms at the outset were on the same page. The latter had the regulatory ability to press many of the reforms internationally and nationally, through the FSB, even as dispute emerged at later, post-crisis G20 summit meetings. Other areas see second- and first-order changes.

The coordinated regulation of the derivatives markets is a high second-order change. The FSB oversees implementation of new regulations over a vast part of the global financial marketplace that until this juncture had no oversight or regulation at all. In this policy space, the outcome demonstrates a dynamic in crisis response and output: the greater the policymaking distance between the coordinating body or negotiators and the actual national policymakers in a market, the greater the chance of disputes, a suboptimal narrative, and the weaker the regulatory policy outcome. Moreover, when policy actions require entirely new legislation and national regulatory action, domestic interests have opportunities to intervene and potentially adversely impact the policy process. This may result in a more mixed, less robust outcome.

As previously observed, not all areas of policy evolution move at the same speed or over the same distance. This is no surprise. Some issues are simply too difficult to resolve (such as global imbalances), or the policy consensus does not yet extend far enough to create the necessary “win sets” (for example on aspects of “too big to fail” or on accounting standards). Viewing such varying outcomes as incidental or as critically undermining the case for a new worldview and its impact depends on one’s perspective. Both big jumps and incremental steps are important to closing the gap between policy goals and outcomes.

Agents of paradigm shift in the policy consensus in the financial stability and environmental spheres face many challenges. But proponents clearly need to close the narrative gap and policy implementation gap between the scientists and key diplomatic, financial, and regulatory communities that are holdouts resisting a new consensus on the importance of including climate change (broken down into measureable quantifiable risks) within financial and economic markets, and within regulatory requirements for individual firms.

The most desirable outcome would be for “eureka” moments to occur soon within the leadership of key holdout states and agencies. Such developments cannot be completely discounted. Perhaps increasing weather-related events (droughts, floods, forest fires) may have begun to collectively force a sudden shift in political leadership, policy stance, and public opinion in recalcitrant states.

Instead, incremental first- and second-order changes can collectively make a significant difference and may constitute the small building blocks of a paradigm shift. In this sense, the emissions rules of Californian legislators and regulators help to shift the debate and practice towards a new financial stability-environmental consensus. This is also exhibited in the views of the US Department of Defense on climate change, which may be additive, because public procurement decisions are impacted, and this resonates with the defence industry. In this manner, the actions of regions and states in support of the International Panel on Climate Change (IPCC) goals and their implementation, from the European Union to German renewable usage and Chinese policy shifts, all add to the desired shift, even if they do not amount to treaty-level endorsements. Herein lies another lesson from the financial crisis response.

8 Using soft-law mechanisms as a viable second option

Almost all the financial reforms described in this paper as collectively constituting the paradigm shift in the application of state and central banking regulatory power and authority over global markets and firms take the form of non-binding agreements among sub-state regulatory agencies, backed by governmental agreement, national regulations, and national implementation. The reforms are not binding state-to-state treaties.

The reforms are not “hard” law, but “soft” law in their formulation. Critics point to this as a fundamental weakness (Helleiner, 2014). According to this legalistic view, only binding treaties are worth the effort; other lesser documents, essentially the entire output of the G20-FSB processes, are suboptimal at best, or meaningless at worst. This is a fundamental error in analysis and a misconception about the ongoing and meaningful impact of the financial reforms.

Contrary to Helleiner’s position, the soft-law nature of the G20-FSB process has allowed financial reforms to proceed faster, with more detailed content and oversight, than a treaty format could have achieved. Sub-state actors, the central banking community and its leadership, brought together within their own construction (the FSB), were able to delineate and pursue a multi-year program of detailed reforms immediately beginning in 2008-2009, laying out work for hundreds of regulators and scores of agencies across the globe, backed by G20 authority.

It is not the case that the financial reforms are minor and lack impact simply because the agreements struck in the FSB and other standard-setting bodies at their behest are soft law. Any banker will refute that the Basel III Accord and the multiple new limits on their business activities are any less important because they do not result in state-to-state treaties. Today, markets price in the Basel III standards when measuring the health of banks’ books, and investors expect them to be applied state to state; markets penalize weak, undercapitalized banks accordingly.

The proven effectiveness of this soft-law approach in the financial reform space points to lessons for the environmental space. Could a soft-law approach, with agreements struck among sub-state agencies, be useful? Should this approach be part of a dual-track strategy, running parallel with the IPCC negotiations, which are much harder to move forward precisely because of the binding nature of the deals they produce?

It is notable that the Obama Administration appears to be moving toward this soft-law sub-state-level approach as it seeks to move forward despite the restraining hand of the US Congress. Confronted by an immovable Congress, President Obama is looking at other ways to achieve carbon reductions short of a treaty. Others have already recognized this, such as the founders of the Regional Greenhouse Gas Initiative trading platform among US states; they did not wait, but moved forward regardless of the diplomatic hurdles. This suggests that soft-law approaches need to be considered as one avenue that may help shift the policy consensus and paradigm.

Those involved in moving the consensus narrative on climate change should continue to use soft-law opportunities to advance their goals. Doing so has many benefits and can bring the tipping point of the consensus policy narrative and related paradigm shift closer to us.

9 There are multiple pressure points for change

Continuing to apply political and policymaking pressure at multiple points and via different forums may positively affect the direction and shape of current and future policy consensus that integrates climate change risks into financial regulatory decision making and policies. At the highest level, treaty agreements are uppermost in the UN framework. Simultaneous approaches are needed at multiple other levels and via other routes to shift the consensus.

The FSB can be influenced via language contained in the G20 declaration and summitry processes (, via downward political pressure) because the Board has to act on G20 directions in the area of its mandate and mission. The G20 launch of a Green Finance Study Group jointly chaired by the Bank of England and People's Bank of China in 2015 is a case in point. Here, pressure from the G20 process should help alter the policy narrative and force actors and ministries to address finance and sustainability within the G20 process. By extension, this will require action by policymakers in the FSB.

The FSB can also be affected to a degree by upward influence from below. For example, the International Association for Insurance Supervisors (IAIS), which sits below the FSB, has a much better intuitive and risk management understanding of environmental factors, because it is involved in the regulation of global insurance and reinsurance firms that have to include climate change and other environmental risks in their models, or potentially go bankrupt. The IAIS may therefore be a possible conduit for change inside the wider supervisory community consensus.

Many other possible examples of pressure points may help change the policy narrative and consensus. All should be used to effect the consensus broadly speaking, and within individual sub-communities of voters, actors, investors, regulators, supervisors.

10 Emerging countries are important to the paradigm shift

It is a common refrain that the emerging markets lag the advanced economies in embedding policy shifts in their processes. This is not always the case. For instance, emerging countries notably used macroprudential policies to manage risks in their economies long before the 2007-2008 crisis. In this real sense, they were ahead of the advanced economies in recognizing the importance of broader tools to use throughout the economic cycle; it is not surprising they supported this shift. This example demonstrates that policy advances that affect financial regulation also (perhaps) climate change consensus may arise outside the core.

Before the crisis, central bankers in developed countries did not, as a community, use macroprudential tools. In fact, they scorned them, leaving it to the emerging countries to use them more widely.

The sudden shift in 2009-2010 and since underscores the fact that resistance by supervisors and regulators to considering environmental risks in their models and oversight practices is not permanent and intractable; rather, it too can be subject to sudden change. That is, if the dominant community consensus norms shift, so can the regulatory worldview and approaches that are demanded of sub-state actors charged with carrying out policy reforms.

Conclusion: Identifying the precise tipping point is always difficult

A final lesson from past shifts in policy consensus, and in the current financial regulatory shift that is still under way, is that when you are experiencing a paradigm shift, it is often difficult to identify the precise tipping point in the consensus and worldview. An individual observer is simply too close to events to fully comprehend them. Only with greater temporal distance can a shift be seen.

When Mrs. Thatcher came to power, people did not immediately view her electoral victory as a fundamental shift. Indeed, in the first few years, her cabinet was stacked with Tory “wets,”* the country experienced a severe recession, and the Prime Minister was massively unpopular. It was only some years later, after a split in the Labour Party, after the Falklands War, and after crushing the miners’ strike in 1984, that her impact gradually became more widely recognized.

In other words, the policy consensus shift desired by the UNEP Inquiry and encapsulated in the conference is already fitfully under way, but difficult to discern fully. Scientists operate in the new paradigm. Some policymakers and political leaders are also making decisions within that new policy universe. Others stubbornly cling to outdated notions and erroneous theories. Continued pressure and action on multiple levels—societal, political, and policymaking—are therefore needed to continue to alter the speed of the consensus shift, and to secure a final definitive jump to a new paradigm that marries financial stability, environmental risk, climate change, and other societal risks in a unified narrative and policy framework. The UNEP Inquiry’s work is crucial to that endeavour.

A Postscript on COP21

The conclusion of the COP21 negotiations and the signature of the Paris Agreement in December 2015 provide reason for optimism that the narrative consensus and paradigm shift tipping point is closer, or may indeed now have finally been reached. ‘Win spaces’ were created between key actors, including, crucially, China, and the United States. Other governments that had blocked previous agreements were forced into a compromise. At the geopolitical level, the policy consensus appears to have altered meaningfully with the addition of these key players. This is further buttressed in particular by a notable public opinion shift in the US, where a majority now views action of climate change as a matter of urgency.

In addition, long-standing insistence on binding treaty norms, which had led to stalemate, was jettisoned in favour of a potentially more productive soft-law approach. This approach—the one used successfully in the global financial regulatory space—should allow countries and sub-state agencies to pursue goals collaboratively via alternative mechanisms, many the details of which are still to be delineated. This is a strength, not a weakness. It gives the ability to set detailed goals back the specialist communities who need not wait for political action, but can instead shift policy based on the now visible emerging climate change consensus.

The evidence of the soft-law-based paradigm shift in the global financial regulatory space and its related architecture suggests that this soft-law alternative approach to global regulation could prove effective and allow continued policy evolution in support of a broader consensus community narrative on climate

* A term coined by Mrs. Thatcher in 1979–80 for members of the Conservative Party in Britain who opposed some of her more hard-line policies. She used the term to connote weakness and a willingness to compromise with the Labour Party.

change. The technical G20 work stream on green finance is further tangible evidence of the importance of that process. It is bringing scores of technocrats from across the globe from key central banking and finance ministry roles into an ongoing dialogue that will begin to embed the new narrative and policy norms within technical rules, within monitoring and peer review efforts, and (more slowly) within market practices and approaches. This ought to strengthen the narrative paradigm shift which Paris signalled and supports. And so in this manner, the Paris Agreement, which some see as weak, could in fact prove to be stronger in the medium term than many expect. Perhaps looking back from some years distant, the Agreement will be seen as the final tipping point of the climate change paradigm and policy consensus. I certainly hope so.

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