

Transcripts of the interview with Erkki Liikanen (chair of Trustees of IFRS Foundation) – May 2024

Caterina Rho:

Hello everyone and welcome to the new episode of interviews with top sustainable finance scholars, the European Commission Sustainable Finance Research Forum Interview Series. My name is Caterina Rho and I am the Secretary of the Forum. Today I have the great pleasure to discuss on Global Sustainability Disclosure Standards with Erkki Liikanen. Thank you very much Erkki for being with us today!

Erkki Liikanen:

Thank you very much.

C.R.:

Mr. Erkki Liikanen is the Chair of Trustees of the International Financial Reporting Standards Foundation, or IFRS Foundation. He's also the chair of the board of Bruegel, a European think tanking in Brussels, and the chair of the Ethics Committee of the ECB. Erkki has an outstanding international career as an economist, diplomat and politician. Before his appointment at the IFRS he was governor of the Bank of Finland from 2004 to 2018. He was a 10-year chairman of the ECB Audit Committee. He was also Governor of the International Monetary Fund for Finland and he worked at the European Commission, responsible for Enterprise and Information Society and for Budget, Personal Administration. In the 90s, before starting his international career in international organizations, Erkki was an ambassador and Head of the Finnish Mission to the European Union and started his political career as a member of the Finnish Parliament at the age of 21, being also Minister of Finance for Finland. So I'm really glad that we have such an experienced policy maker to discuss with us today. Erkki, last year in June, the International Sustainability Standards Board of the IFRS issued its inaugural Sustainability Disclosure Standards. Can you give us an introduction about what are sustainability disclosure standards and how the IFRS arrived at this point?

E.L.:

Thank you very much. There's perhaps one aspect that is: how did I get involved with this sustainability issues? It was late 1980s. I was a young Minister of Finance and economist. I read many basic works of Professor Nordhaus, who later became Nobel Prize winner, and he explained that in the end you must internalize the costs of emissions to make a difference in the marketplace. So as young minister was very excited about that and I actually proposed: why don't we create a carbon tax? Our senior staff was very much against. They said that it's never been done anywhere, so it doesn't work. But there was a junior young economist who said to me that I may try and he came back a week later, the draft where would have would change excise duties of our CO2 products. So that, high was the emissions, high was the duty. It became draft law and it was adopted and entered into force in 1990. Interestingly, that has turned out to be the first carbon tax in the world. It's in the reports of the World Bank and also reports of a Business School, the London School of Economics. And now I just very recently saw the last research paper on Finland by a Professor of Economics last year. We've told that actually from that day on, the emissions of the transport sector really slowed down and there have been clear differences between Finland and the other countries. I just say that that's like long history and interest in that area I have had always. And when I was Commissioner we were also at that time we created the... became part of the International Financial Reporting Standards because there were many crises in the in the banks and other Finnish institutions and there were no comparability of reporting standards. Nobody would trust them. So Paul Walker was the first Chair of Trustees. He was promoting global standards, and the European Commission joined that effort and we were able to create so-called IFA standards for financial reporting. At the same time

we had the Kyoto Protocol, but that was divisive issue. You know, when George W. Bush became president, the United States withdrew from the Kyoto Protocol. So finance reporting continued, but then the sustainability was a separate issue there, they went to different directions. But now, after Paris summit 2015, there was more consensus that something must be done politically, standardization efforts also. But there were so many that people spoke about “alphabet soup”. There were so many different acronyms, you couldn't follow it. So when I became the chair of the IFRS Foundation Trustees, there were requests that we should go to that territory. But we decided that we don't do until unless there's a clear public demand, broad consultation. And we organised this broad consultation. Key person was, by the way, the Italian Professor Lucrezia Reichlin, who has been also Trustee. We made consultation where practically everybody agreed that it's time to have global standards, and second was that we should either should play a role there, and we should causally date this alphabet soup. So that all happened in 2019-2020 and when we are approaching Glasgow COP 26 Climate Summit, we had Italian presidency on G20 and I was very happy to be invited to the G20 meeting in Venice in July. We were able to present the first plan that we would be able to move forward to create sustainable standards born and also start considering sector. We got very strong report from Italian presidency at the time. So the next step was actually in November 2021 in Glasgow, where I was asked to make the proposal, and there were three concrete proposals established now, a sustainably standard spot parallel to financial reporting. So they would be separate but complementary. Second, consolidate the sector, and third, publish the first two standards of the prototypes. So that happened in November, in Glasgow. And since then, there has been a very rapid rapid progress. In two years, last year we got the two first standards, S1 and S2. One is the general requirements, the other one is for climate. We have practically consolidated the sector. And thirdly, thirdly is international sustainably standard spot is operational. So it's very much work in the progress. I'm sorry my reply has been a little long, but I wanted to give the whole story. So Italian president, Italian presidency, G20 was very helpful here.

C.R.:

Thank you very much. It's really fascinating that you were at the very beginning of everything, even the first carbon tax in the world that was developed by you in Finland. And it's really interesting how you stayed within the sustainability policy interest through all your career. So that my second question would be linked to this first. The European Commission last July also issued some Sustainability Reporting Standards that are the European Sustainability Reporting Standards. But at this point, how these European standards and the ISSB standards can interact? Does it need to be confusing for investors and agents on the market or is part of a common global scheme?

E.L.:

These actually very important concrete questions today, because Europe was here ahead of other continents and Europe moved on earlier than the others. And all credit to European Commission and European policy makers. Of course, I was commissioned for a long time, so I feel very happy about it. But there's also a problem. Climate is a global problem. Whatever Europe does, it's 8 to 9% of GDP globally. And as somebody said in one report, French report with top economists, they said that if China and India are out, the rest doesn't matter. Of course it matters but it gets some essential point there. So, so we had to somehow to find a solution where how could the European solutions and global interact. So what we try to do globally is to create a global baseline, which would include the whole globe and actually like I say today that even you know let's say Japan has already decided to support them. Chinese comments have been quite positive. We have many African countries who want to join the global baseline, Brazil, Turkey, so these there, this kind of baseline because this global problem, capital markets are global, must be there together. But then if European standards are higher, what is the problem? Problem is that if the companies need to report the same issue twice, it creates a lot of confusion, lot of paper bill, lot of bureaucracy. And I'm very happy to say that in a good spirit of cooperation, the IFRS Foundation and EFRAG, which is standard in body of the of the EU have been able to adopt now in May a kind of interoperability guidance. So the two standards have been analyzed and interpreted in the way that once you when you report once, it's accepted also by the other standard. The paper looks very complicated,

it's about 33 pages long and I don't go all the details there, but when today your tools are navigating, tools are electronics for companies, it makes it quite possible. So in the ideal world, I hope what will happen is that the global baseline which we'll work on will be implemented everywhere and it will be part of the European standards. You don't need to report twice but if Europe then has higher requirements for some other aspects it would be like extra building block above this solution that's why we are now so and I'm very happy to say that we have been working good spirit with the European Commission and and it's it's it's now done this interpretability guidance is available for all companies reporters academics who want to study in the area so together better but one baseline is critical for the whole world.

C.R.:

This is crucial. Thank you very much for for clarifying this because working in on the topic of sustainability and speaking with both academics but also market participants and banks, the most common comment that I receive is that the European Commission is making things difficult, or these policy requirements are difficult to implement. But knowing that some of these requirements are common and are following the global standards would be for sure helpful also for market participants and companies and that we agree.

E.L.:

And it's also important to keep in mind in Europe that if the problem's global, we can't solve it alone. So whatever we do in the future, we strive to work for the global solution. And especially, I want to emphasize the role of the global South, Emerging and Developing nations, nations, because they are main victims of climate change. So we must have them as a part of this process, as a part of those who build out this new future because of climate change. So together it's better. We do our own story, but let's work also together. And I've been travelling in Africa. I met people that I've been positively surprised how common many countries are and how could profession, even accounting in many countries have in spite of all difficulties.

C.R.:

So in the spirit of thinking about a common policy package, the sustainability disclosure standards are one key tool to to quantify and monitoring climate risk. But considering a global approach to policy, what are other best practices that may be implemented along with the standards that you know from the experience of other partner countries or the European Union to reinforce a possible sustainable or sustainable transition strategy?

E.L.:

I would I would say so that there are like 3 pillars of actions we need to do in the fight against climate change. One is, first pillar is, political measures. They are in all cases important, as carbon tax, however difficult. But it's a good measure if you solve the problem, the leakage at the frontiers. Emission trading, that's for the same direction because it's controls the amount of emissions and raises the price. So it's like the first pillar, we must move on there. Second pillar critically important is the carbon transition of the company so that companies start to buy and develop technologies where the aim is go down towards net neutrality. So this second part, if the companies don't change, if technology is not used, we will lose this battle. But third is that: how can we help companies and the whole world and change? They need money, you know you need financing. The governments can't finance it all. And there comes the issue of disclosure. Because if we have a proper disclosure of the benefits and risks of the companies and in their emissions, the investor can assess the value of the company. Take that into account. Those companies which have high emissions and no real plans of investment for the change, their values will go down. Those companies who may have the high emissions but at the same time have a plan, investment technology to cut down the emissions, their values will go up. So that the disclosure will help investors to understand the companies versus their value and also directly in reference to those areas which have the plans. So the disclosure is the way to get private money also the transition of the

companies. But all these three pillars what are important you need politics, you need company transition, you need private financing.

C.R.:

Thank you very much. With respect to this three pillars and considering your experience on the matter, what are the main lessons learned up now and what will be the next steps for regulatory institutions and market participants? Are we already at this stage of implementation, or do we need to start somewhere else?

E.L.:

I would say that now in the field of standards, where we have the first two standards adopted, which one is the general requirements of reporting: how companies report? And 2nd is the climate. Once standard are adopted, now we must take them implemented globally. And what has happened? IOSCO, which is the international organization of securities regulations, gave a massive support, strong support for our standards, and advised our regulators to adopt them globally. That's first issue, it'll be there. Second issue which is also very important is that we, you know, we have not only standards which we produce but there are also audit standards. So when audit firms make a report the analyst announced the company they will look at the at the value of the financial side but they also would look at sustainability in future and now when the standards are there about the sustained performance, when the companies give the annual report, your CEO in the future that's not only tell about the about the financial results, but they need to report also on the sustainability performance and especially these two will interact in the long term. If you have a challenge with the sustainable performance it's very clear that it impacts on the company in the long term. So that what we need here, we need that when we have now the standards they must be applied, and then all auditors when they analyze report on that basis. It gives this strong push from markets and also market power behind this all. So I think this is critically important to understand and these all play their own role: public policies, disclosure, and company transitions. Where we will have a problem and problems in the future? It's of course so that you know this political cycles come and go, and people's preoccupation come and go but this climate issue will not disappear. That's why I think we all people have impact on the public opinion. All policy makers must keep their mind focused. Don't leave away our targets of slowing down the climate change. Keep the focus there and even be able to take decisions which may be sometimes painful. And there's of course one area which is linked to the carbon taxes or emission tradings which may have also redistribution effects which are not simple. So those people who live far away need the car to go to work. They don't have other options. So we need to think in policy measures how those people who may have these difficulty because of the carbon, of the policies against climate change that they are also supportive. So I've said this political party is also important, but in principle still 3 pillars: politics, capital transition, disclosure are the key and one should think in those terms.

C.R.:

Thank you very much. These three pillars will be the guide for policy makers in the future for sure. And if I may, I have also an extra question more for, if you think about it, more for young researchers. So in your experience as an economist, do you have any suggestions or where would you like the research, policy based research, to go considering these three important pillars for climate economic policy in the future?

E.L.:

There's one particular aspect, it's about accounting. I mean, accounting is considered to be a boring subject, about the figures. But now sustainability changes the big picture, because when you do accounting, when you have on the one hand financial accounting, second, sustainability accounting and you interconnect them, you can do really an analysis of the company and also look for the change of the world. And I must say that that's

a very exciting opportunity, and those young people who are looking at accounting today also put a focus on sustainability. I have a couple of interesting experiences, because I know one young colleague who was working for sustainability accounting, and I gave him a call 3 months ago that where are you nowadays? I'd like to have your advice. He said, you know I'm working with one of Big 4 companies. They bought my company because they say that they know financial accounting is not enough. They want to have also sustainability accounting at the same time. So that, young people who are working in the field of accounting, which is also terribly important, add up the sustainability in that area, and you will be forefront. Secondly, I must also study economics in general. I think this basic learning is what we learned from William Nordhaus and others that if you want markets to work, they must internalize the cost of the emissions and, you know, go deeper there. Try to understand and we make a strong case behind these issues, because in the end of the day, my belief is that unless you can make it a strong case in terms of economics, you can't convince the others. So even in the macroeconomic area economics of environment is terribly important. Both of micro, from, you know, accounting, to macro, big issues, they are very important. So I mean exciting world now for young students because so much happens on the agenda and there is also very much value added, because I think we most people know that if you look at the figures, how the globe is heating up, they are just unquestionable, and we need to act and to make the actions consistent, solid, you need to have good research based there.

C.R.:

I'm sure that these are challenges that are very close to the heart of young researchers, also considering how in universities, and even high school students, are committed to environmental issues this time. So thank you very much for your suggestions and our discussion today about these topics. I'm really impressed by your enthusiasm, you know, also after all these years. I think for you it's also a nice outcome of your work starting from the very first carbon tax to the kind of wide audience that these topics are now discussed in these days. So thank you very much for your work and I appreciate also all your replies during our conversation today. I had a lot of interesting points to think about during my research work, for sure, and thank you for addressing the challenges that sustainability disclosure standards already solved and also the challenges that remain to be addressed in the future. Thank you very much.

E.L.:

Thank you. Bye bye.

C.R.:

Closing our interview, I will also say goodbye to our audience. Stay tuned for the next episode of the Sustainable Finance Research Forum Interview Series that will arrive in June. See you again on this channel!