PositiveMoney

Greening Financial Flows

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The government's Green Finance Strategy (GFS, March 2023) contained some positive signals. We welcome plans to set KPIs for a net zero aligned financial centre, net zero 'investment roadmaps' and financial flow tracking, and an acknowledgement of the importance of nature.

However, current plans are falling short and progress is stalling in key areas. The UK's Green Taxonomy and implementation of Sustainability Disclosure Requirements have been repeatedly delayed, and Bank of England action to integrate climate into its collateral framework and capital requirements has stalled. Recent research by E3G and WWF estimates that there remains a clean investment gap of £81–£111 billion between now and 2030, equivalent to 25–34% of the total investment required in key economic sectors.

Incentives for green investment are no substitute for winding down investment in fossil fuels. The new GFS focuses primarily on creating and supporting sustainable markets, but is missing any meaningful action on winding down financing of fossil fuels and other environmentally destructive activities. As the CCC has set out, the central challenge is to move from private sector engagement and measuring climate risk towards actively shifting financial flows.

WHAT IS MISSING FROM THE GFS?

Public investment: it is concerning that energy and climate were notably absent from the prime minister's "five key priorities" for the UK in January, and the 2023 Spring Budget did not include any newly allocated net zero public investment.

- ➔ The government should increase strategic public investment in the transition.

Public finance institutions: We agree with the government's assessment that public finance institutions have a key role to play in the transition. It is therefore disappointing that the GFS contains no new public investment to increase their capacity. UKIB is constrained by its small capitalisation of £12 billion (as well as £10 billion loan guarantees), falling short of £5 billion a year on average the UK received from the European Investment Bank (EIB) ahead of the Brexit referendum.

- ➔ The Treasury should increase capitalisation of the UKIB and the British Business Bank.

Reducing the cost of green credit: The new GFS rightly highlights the need to lower the cost of capital for activities aligned with the transition, but fails to include policies to directly reduce the cost of green credit.

- ➔ In a higher-interest-rate environment, the government and the Bank of England should use targeted lower interest rate lending schemes and coordinate monetary and fiscal policy to ensure critical green investment is not impaired by the higher cost of capital.
- ➔ The Bank should also decarbonise its collateral framework to remove the implicit carbon subsidy embedded in the current approach, which the European Central Bank has already committed to doing (see Positive Money briefing here).

Financial risk: The GFS recognises that "climate change and environmental degradation pose profound risks to the economy" (GFS, p8) but sets out no plan to tackle them. The Bank of

England has also indicated that it is delaying action following its recent climate and capital requirements review.

- ➔ To protect against a build-up of systemic risk, the Treasury and Bank of England should work together to fully integrate climate and nature into prudential and monetary policy frameworks, and ensure the high risk of fossil fuel financing is reflected in its capital framework.

Regulator mandates: The GFS rightly recognises the role of regulators in supporting the strategy's goals, but the government's Edinburgh Reforms are pushing regulators into a 'race to the bottom' on regulatory standards through the new objective of promoting 'international competitiveness' and are likely to increase risks in the financial sector by lowering capital adequacy requirements.

- ➔ The government should give financial regulators *statutory* objectives for net zero alignment and nature protection, and clear remits for the phase-out of fossil fuel financing.

HOW COULD CURRENT POLICIES GO FURTHER?

'Net Zero Investment Roadmaps': the government's commitment to publish these is welcome, and the new 'Net Zero-Aligned Financial Centre' framework makes a first step towards establishing appropriate governance and KPIs.

- ➔ To be effective, the roadmaps must include: i) detailed sectoral analysis; ii) independent tracking of investment gaps; iii) a clear policy for how gaps will be filled by public and private sources; iv) accountability mechanisms, empowering an independent body (such as the CCC) to assess progress, and a clear process for the Treasury, Bank of England and regulators to act on their recommendations.

Taxonomy: it's positive that the government will be consulting on the UK green taxonomy in Autumn 2023, after delays to the process.

- ➔ The government should ensure strict science-based criteria and clarify that gas and biomass will not be labelled 'green' in the UK taxonomy.

Transition plans: The GFS commitment to consult on disclosure of transition plans by large companies, as an extension of the FCA's current requirement of listed companies, is welcome. However, the FCA's current "comply or explain" basis for the disclosure of transition plans does not amount to the COP26 commitment of mandatory disclosure.

- ➔ The government should extend transition plans to all large companies on a mandatory (not 'comply or explain') basis, with robust frameworks to oversee implementation.

International: the GFS lists supporting the alignment of global financial flows with climate and nature objectives as one of its goals and identifies reform of the international financial infrastructure as a key aspect for the UK to influence. However, it is concerning that the government has left a loophole open for ODA to still support fossil fuel energy overseas 'in exceptional circumstances'. The government must:

- ➔ Ensure high integrity implementation (by closing such loopholes) of its commitment to end public financing for new fossil fuels overseas, and expand this to private finance.
- ➔ Outline how the UK's priorities in reforming international financial institutions (e.g. the World Bank & IMF) would shift global financial flows to meet the transition and adaptation financing needs of low- and middle- income countries, and commit to supporting Paris-aligned financial regulation at a global level, including through the Basel Committee.
- ➔ Commit to scaling up grant-based financial assistance for low-income countries.