Written evidence submitted by Bright Blue

About Bright Blue

Bright Blue is an independent think tank that champions liberal conservatism. Our work is guided by seven research themes: Bountiful economy; Clean environment; Good lives; Rewarding work; Empowering government; Just institutions; and connected communities. We were shortlisted for the UK social policy think tank of the year and UK environment and energy think tank of the year multiple times in the prestigious Prospect Magazine annual awards. We have conducted extensive research on decarbonising the power sector and the gas network in particular which we wish to submit as evidence.

Introduction

In April 2022, Bright Blue published a report titled, "Greening UK Export Finance", which examined the progress that the UK has made in its efforts to phase out financing of overseas fossil fuel investment. The report was seeking to assess to what extent the current UK policy and economy aligns with the goals set out in the Paris Agreement, and what policies should be adopted to further achieve these goals. This research was conducted using 4 methods: a literature review, stakeholder consultation with the relevant government officials and researchers, polling 750 UK exporting firms, and applying the Perspectives Climate Group's ECA Paris Alignment assessment to the data.

The role of ECAs and their climate impact

Despite the commitments under the Paris Agreement, it has been estimated that the G20 countries' ECAs provided at least USD 23 billion in public financing for overseas coal projects from 2013 to 2016 and only around USD 3 billion for overseas renewable energy projects in the same period. Worse, it has been estimated that from 2016 to 2018, the ECAs of the G20 countries provided an annual average of USD 40.1 billion to support all fossil fuel (coal, oil and gas) projects. A staggering 79% of this came from only four countries: Canada (more than USD 10 billion), Japan (more than USD 8 billion), China (close to USD 8 billion) and South Korea (more than USD 5 billion).

A recent study by Perspectives Climate Research reviewed climate policies that apply to different ECAs across the world. It demonstrated that there are very few explicit requirements to phase out support to fossil fuels and more broadly align ECAs' operations with the Paris Agreement.

Binding international agreements

The most relevant – and the only binding – international policy framework for export finance is the 1978 OECD Arrangement on Officially Supported Export Credits (referred to as the 'OECD Arrangement') whose purpose is to foster fair competition – the so called 'level playing field'. Major G20 members participate, namely Australia, Canada, the European Union, Japan, Korea, New Zealand, Norway, Switzerland, Turkey, the United Kingdom and the United States. But not China.

There are currently six 'OECD Sector Understandings', which are part of the OECD Arrangement and which comprise additional sector specific rules. Two of them are directly relevant for the climate impact of ECAs:

- **The Renewable Energy, Climate Change Mitigation and Adaptation and Water Projects Sector Understanding (CCSU).** Recognises exports of climate-friendly technologies and projects which contribute to climate change mitigation. These exports are allowed to receive more favourable conditions from ECAs, such as longer credit periods or lower interest rates.
- **The Coal-Fired Electricity Generation Sector Understanding (CFSU).** Provides stricter terms and conditions for the ECAs' support related to coal-fired electricity generation projects.

In October 2021, in the run up to COP26, an agreement by the OECD to tighten these rules was introduced. Consequently, this banned officially supported export credits and tied aid for:

- New coal-fired power plants without (CCS) facilities.

- Existing coal-fired power plants, unless the purpose of the equipment supplied is pollution or CO2 abatement and such equipment does not extend the useful lifetime or capacity of the plant, or unless it is for retrofitting to install CCS.

While phasing out coal support is a welcome development, the OECD Arrangement does not restrict support to oil and gas sectors at all. The OECD Arrangement thus does not lead to sufficient ambition to fully align officially supported export finance with the Paris Agreement and the latest climate science.

Overview of UK Export Finance

UKEF operates as a government department, principally related to the Department for International Trade (DIT). UKEF's core mission is "to ensure that no viable UK export fails for lack of finance or insurance, while operating at no net cost to the taxpayer".

Through its financial support, UKEF aims to achieve three primary objectives: the acquisition of foreign contracts by exporters; the development of export projects through capital lending; and the 'de risking' of investments and transactions with overseas clients. UKEF is subject to the policies and oversight of the UK government and, ultimately, the UK Parliament.

Delivered through private financial institutions (FIs), UKEF offers different forms of support (or 'facilities') to assist UK exporters developing projects overseas. These facilities at UKEF take the form of loans (financing), insurance and guarantees – as per UKEF's own classification. To generate returns to UK taxpayers, UKEF charges varying rates of commercial interest on the loans, insurance and guarantees provided to exporters and sets risk premiums on a case-by-case basis.

Similar to other ECAs, UKEF intervenes to support export projects where financing is unavailable in the private market, or where providing loans, insurance and guarantees would incur excessively high risks for private FIs. According to the polling conducted for this report, this financial support is vital for UK exporting firms:

- ⌘ A majority of 68% of UK exporting firms say that financial support from UKEF is very important or important for sustaining their firms' exporting business.
- ⌘ A majority of 58% of UK exporting firms that are familiar with UKEF approve of the quality of services rendered by UKEF.

Climate-related processes and policies in UKEF

Historically, UKEF's support for exporters within the energy sector up to now has been heavily oriented toward carbon-intensive projects. According to the House of Commons Environmental Audit Committee, between 2013 and 2018, UKEF provided £2.5 billion for energy projects (equivalent to around 21% of all UKEF financing), with only £104 million going to low-carbon or renewable energy projects. UKEF therefore has come under intense criticism recently for financing a variety of fossil fuel projects overseas.

Responding to this criticism, UKEF has redefined the roles of other strategy and policy personnel to incorporate climate-related considerations and established a new position, Head of Climate Change, to lead on climate policy formation and strategy across a number of areas. This includes the disclosures related to climate impacts and risks, intra-government coordination around COP26, UKEF actions on compliance with Sustainable Development Goals (SDGs) targets, and engagement with civil society, NGOs, international ECAs and FIs.

In 2021, the UK became the first country to actually implement – not just commit to – a phase out of most loans, insurance and guarantees for the development of fossil fuel export projects overseas.

Beyond the phase-out for financing all new fossil fuel exporting projects, in September 2021, in the run up to COP26, UKEF published a comprehensive Climate Change Strategy for 2021-2024. The strategy has an overarching objective of net zero emissions by 2050 and is built on five strategic pillars:

1. Increasing support for clean growth and climate adaptation.
2. Reducing GHG emissions from its financial portfolio.
3. Improving understanding and mitigation of climate-related financial risks.
4. Reporting against climate-related commitments, enhancing transparency and disclosure.
5. Leading internationally, encouraging others to follow UKEF's lead and set ambitious climate targets.

Recommendations

Climate finance

Recommendation: Set new targets for UKEF: a) a year-on-year increase for the proportion of climate-friendly financing across all of UKEF's portfolio, and b) that half of all financing will be climate friendly as soon as possible.

Recommendation: Introduce a climate-reward system for exporters for UKEF financing, such as smaller premium or interest payments.

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