Evidence from the Grantham Research Institute on Climate Change and the Environment

I am writing to respond to your letter dated 9th April 2020, addressed to the Grantham Research Institute via our Director Professor Sam Fankhauser. You requested answers to a series of questions relating to the Environmental Audit Committee's work on COP26, Finance, Business and COVID-19. The Grantham Research Institute is now conducting work examining the impact of COVID-19 in a number of different areas, including linkages to the UK's efforts to decarbonise. We would be very happy to share our findings with you as they emerge. Ahead of this, you may find answers below to the specific questions which you asked, drawing on work which I am currently involved in.

Question 1: The role of public / private finance, and investors and businesses in tackling climate change

The decisions the UK makes in the next 10 years will define whether or not it maintains its position a global leader in tackling climate change into the long term. Investments in infrastructure need to be carefully considered, alongside investments in skills and innovation, with public investment designed to leverage private investment. Infrastructure assets have a long life-expectancy – ranging from 10 to 20 years for roads through to 50 years-plus for rail tracks, bridges and transmission lines. The UK needs to lock in to a zero-carbon, resilient pathway that avoids building high-carbon or vulnerable infrastructure that will rapidly lose value. The recent decision to rule plans for a third runway at Heathrow Airport illegal due to their incompatibility with the Paris Agreement on climate change makes clear that the Government must take account of its domestic and international commitments on reducing emissions of greenhouse gases when making decisions about long-lived infrastructure projects. Across infrastructure and other economic assets the invention and diffusion of zero-carbon technologies and practices are crucial; increased investment and collaboration between government, industry and research institutions will be key to achieving this. There is an urgent need for ambitious policymaking that emphasises innovation of technologies while also rolling out existing solutions at a scale that can drive down costs. Increasing public infrastructure investment offers private investors such as pension, insurance and sovereign wealth funds a reliable source of long-term income from sustainable assets (via gilts, for example). Green bonds – bonds designated for climate-related projects. New UK-focused green bond products, supporting activities aligned with delivering a 'just transition' for instance, could raise funding for zero-carbon, resilient and socially inclusive investments (including in skills and places with below-average productivity).

Q2: What the UK can do to drive action from these sectors

The UK needs to take a holistic approach to policymaking across these areas, which we outline in our recent report. One critical policy intervention required to mobilise private and public investment at scale is to establish a National Investment Bank. This should have a focus on managing and reducing risk in infrastructure projects, to leverage private finance. The Bank should have an explicit sustainability mandate, seeking out net-zero-aligned projects for which risk levels need to be reduced. A combination of the right financial instruments that lower the cost of capital and operating under a shareholder structure can make these projects viable investment propositions, enabling and fostering the participation of the private sector. Ultimately, establishing such a Bank will facilitate the movement of capital at scale towards net zero-aligned projects that cannot currently be financed by the market. The Bank could act as part of a net-zero institutional framework that can operate transparently and independently of political changes, making it a major positive legacy project for the current government.

The UK has been world-leading in greening the global finance system and spurring innovation but has been less effective in delivering domestic green investment. Investment flows to date suggest that the UK's financial services sector may need assistance in directing capital towards UK assets. With regard to private finance provision, the Government should set out a roadmap for bringing the financial system into alignment with the goals of a resilient, net-zero economy. This can build on the growing desire by both UK financial institutions and individual savers to deploy capital at scale for the transition. Fundamentally, green finance must become more clearly rooted in the bottom-up needs for innovative investments in communities, cities and regions across the country. UK-based investors following the recommendations of the TCFD now have a clear mandate to seek out transition aligned investments, providing an opportunity to match supply of finance with demand from net-zero-aligned, resilient domestic projects.

Question 3: How the UK can continue this drive whilst it tackles COVID-19 and the impact on our economy, the global economy and society

The Grantham Research Institute is currently conducting work on this topic, and will share any materials developed *under this programme of work. The text below provides a high-level summary of the issues under discussion.*

The UK Government's response measures to COVID-19 need to be framed within an overarching set of objectives including meeting net zero emissions by 2050, levelling up by reducing inequalities within and between regions, improving productivity and investing in infrastructure, in doing so forging a new role for 'Global Britain' in the world. The government needs a clear strategy for meeting these objectives in light of the COVID crisis, underpinned by policies and finance to deliver the investment required as we move from the immediate 'rescue' phase to economic recovery. It is critical that decarbonisation is positioned as *helping the UK to deal with economic hardships induced by COVID*, as opposed to contributing to them or distracting from them; otherwise political support will likely fall.

With regard to policy, the UK should look across pricing, subsidies, spending priorities, liquidity, trade, competition, industrial policy, international development policy to optimise policy frameworks to deliver a strong and sustainable recovery that gets the UK on course for net zero. For instance, a well-designed and gradually ratcheting carbon price (e.g. which considers and mitigates distributional impacts on most vulnerable) could be used to raise additional tax revenues, which could be hypothecated across the economy (e.g. healthcare) while still sending a clear price signal to decarbonise. However broader policies, regulations and frameworks all need to continue to direct investment and innovation towards net zero; carbon pricing alone is not enough. With regard to trade, agreements which stimulate UK trade with other countries in the recovery should seek to boost import and export opportunities for zero carbon goods and services. This could be one pillar of an internationalist role for the UK as 'Global Britain', setting the stage for the UK to lead at COP26. Nonetheless, securing domestic supply chains for strategically important items should also be a priority.

It will be important for the UK to have the right institutions and frameworks to deliver a net zero- aligned recovery from COVID. Institutions can set a long term strategy and ensure investment decisions align with net zero and the other governmental objectives set out above. Valuing wealth via different types of capital (e.g. physical, social, natural, knowledge) should be at the core of institutional decisionmaking. The current crisis is spurring a huge range of previously unprecedented changes, particularly in scale and breadth of public spending. It is now even more necessary for institutions to value and measure public net assets as 'wealth' as opposed to merely revenue streams or liabilities, as a means of protecting against austerity policies. This view needs to be hardwired into decision making to justify spending and investment on healthcare as well as zero carbon.

Placing zero carbon innovation and skills at the heart of the recovery will be critical. As we move from the immediate 'rescue' phase to economic recovery, infrastructure investment will be an important means of employment. Jobs can be created via 'shovel ready' net zero-aligned projects which can ensure the UK does not lock-in to a high carbon trajectory, such as widespread energy efficiency improvements. However these jobs also need to be underpinned by skilling and reskilling to ensure the UK workforce is well equipped, both to deploy zero carbon solutions at scale and to innovate the next generation of technologies in hard-to-decarbonise sectors, which could contribute significantly to the UK's knowledge economy into the longer term.

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