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Net Zero, Energy and Transport Committee

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Additional written submission for Scottish Parliament Net zero, Energy and Transport committee on climate finance in Local Government

In January 2022, I gave evidence to the Net Zero Committee's enquiry on the role of Local Government. As part of this, the committee invited me to submit further information. Given the financial challenge associated with net zero and adaptation, the City Council felt it helpful to provide a more detailed overview of the current barriers and challenges to delivering the finance needed for net zero, attached.

I trust this is of assistance.

Your sincerely

Councillor Susan Aitken
Leader of the Council

Additional written submission for Scottish Parliament Net zero, Energy and Transport committee on climate finance in Local Government

Context

- Given local authorities are stewards of their areas, and that the public bodies duties regulations under the Climate Change (Scotland) Act 2009 requiring them to transition to net zero and build climate resilience, it follows they also have a strong role in mobilising the additional finance needed to transform their places and associated economies to ones within planetary boundaries[1].
- The current role of the public sector in facilitating net zero spending is well understood – there are significant overall costs, but these are mostly likely to be borne by the private sector, who also stand to make the biggest savings and profits[2]. This is less true on adaptation, which is more predominantly a public good.
- The economic impacts of failing to act are equally large. Work by Climate Ready Clyde estimates this to be at 3.5% of GDP a year by 2070s without adaptation. Adaptation will lower, but not eliminate these costs.
- The amounts of investment needed for net zero are large, and at present, uncertain. Glasgow's costs for net zero are estimated to be between £4 and £29bn[3]. Investments included in this assessment cover both Glasgow and some of the wider City Region. This suggest investment cost of between £2,220 and £45,670 per person, depending on the populations and geographies considered. More support and work is needed to better define these costs to provide greater confidence to stakeholders that Local Authorities understand the scale of the challenge associated with reaching net zero.
- The timing is also critical. Glasgow has committed to net zero carbon by 2030, meaning these figures must be mobilised at around £3.6bn a year between now and 2030. It is clear that current approaches are not delivering this mobilisation at the pace and scale required.
- While costs are high, there are also high benefits – with average Benefit-Cost Ratio higher than a large number of 'traditional' local authority projects, (up to 9:1 for adaptation[4]).
- To counter the known impacts of climate change, projects must also find additional finance needs of around 3-5% to ensure they are resilient or able to adapt, to climate change.

Financing Approaches in Local Government

- Local Government, like the Scottish Government is a currency user, rather than a currency issuer. This means that its budgets must balance, and it cannot use the national treasury to accelerate the pace of net zero (note that the potential for the role of monetary policy to accelerate the transition to net zero is explored in more detail further in this submission).
- Local Authorities have a wealth of options available to finance climate action. These include traditional options such as Public Works Loan Board or borrowing from the UK investment Bank, as well as private investment and innovative mechanisms such as Municipal Crowdfunding but in general, the business models for financing projects is based on grant-based approaches.
- This context has led Local Authorities to focus on two strategies to increase the amount of finance net zero and climate resilience
    - 1) Targeting public funds to public goods (i.e. where there is
    - Structuring bankable projects – (i.e. moving from relying on grants to business models which price in a 'return' – e.g. revenues from transport projects), and
    - 2) Increasing the role of private, at multiple levels, including as funder of Council projects, in a blended capacity and to deliver wider climate aims in their area.

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[1] The UK Government's Net Zero Strategy estimates that Local Authorities influence around 82% of the emissions in their area: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1033990/net-zero-strategy-beis.pdf

[2] Advisory Group on Finance for the UK's Climate Change Committee (2020) *The Road to Net Zero Finance*: https://www.theccc.org.uk/publication/the-road-to-net-zero-finance-sixth-carbon-budget-advisory-group/

[3] UK Cities Climate Investment Commission (2021) *City Investment Analysis Report* https://cp.catapult.org.uk/news/uk-cities-climate-investment-commission-report/

[4] Committee on Climate Change (2021) *UK Climate Risk Independent Assessment (CCRA3) – Technical Report* https://www.ukclimaterisk.org/independent-assessment-ccra3/technical-report/

- Each of the strategies has a range of challenges. To finance net zero successfully, local authorities must lead this process, coordinating and maximising the use of the public funds across strategic needs and project lifecycles from research and development, through to capital funding for projects, and complement it with use of private finance.
- Going forward, the Council sees a portfolio approach, with a mixed set of financing models where risk is spread and shared across multiple finance sources and investments to help minimise the potentially high costs to householders and ensure projects are bankable.

Challenges in structuring bankable projects and increasing the role of private finance

- Whilst the biggest challenges for those working in sustainability in local authorities is structuring bankable investments and navigating the private finance landscape.
- Green and sustainable finance is a specialised knowledge, which is currently attracting a premium from the financial services sector, and which will make it hard for Local Authorities to recruit staff. Training courses are available, but it will take time to systematically train a cohort of knowledgeable people.
- In the meantime, many project proposers and developers in Local Authorities (including Glasgow) lack the practical capacity to structure the number of investments needed in a way which mobilises finance required in ways and means required for private investment, whilst access to such advice is constrained given existing commitments of finance teams.
- Whilst patient private capital that is competitive with PWLB may be available, it will generally be more expensive and more onerous around due diligence. In addition, the changing landscape of Sustainable Finance, means that additional challenges are coming for Local Authorities to leverage private finance. The UK Government's Greening Finance roadmap[5] sets out a range of new standards private sector is going to have to follow, including the Sustainability Disclosure Requirements. If Local Government is to leverage private finance, it will need to address these requirements and position itself as attractive for investment at both the City council level, and the individual investment level.
- In addition, the finance landscape in the UK is rapidly changing and fluid as a result of Brexit with the setup of financial institutions such as the Scottish National Investment Bank, and the UK Investment Bank. Public funds are also changing significantly with the Shared Prosperity Fund planned as a replacement to the previous European Regional Development Fund. This creates significant short-term uncertainty on which instruments will be available for financing net zero and adaptation.
- In addition to the general challenges of local authority financing, there are also many structural barriers for individual investments. A number of 'principle-agent' problems have been identified in energy efficiency, transport and others, which Scottish and UK Governments could addressed[6].

Incremental changes to enable Local Authority finance for net zero and adaptation

To strengthen the role of Local Authorities in financing climate action, there are several changes that could be made to systematically design in a step change. These include

- **Track and disclose financial flows into net zero and adaptation** – at present, no subnational tracking of financial flows in mitigation or adaptation is conducted, making it challenging to understand whether the right finance is reaching the right places at the right time. Methods like CPI's State of Climate Finance could be adopted to understand the current picture and key gaps[7].
- **Consider requiring Local Authorities to publish Resource Mobilisation Strategies for net zero and adaptation**. This would provide more certainty around the role of different financing needs and requirements, helping public sector target capacity building work and signalling to the private sector where support is required.

[5] HM Government (2021) *Greening Finance: A roadmap to Sustainable Investing*. https://www.gov.uk/government/publications/greening-finance-a-roadmap-to-sustainable-investing

[6] UK Cities Climate Investment Commission (2021) *City Investment Analysis Report* https://cp.catapult.org.uk/news/uk-cities-climate-investment-commission-report/

[7] CPI (2021) Global Landscape of Climate Finance - https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2021/

- **Require TCFD disclosures in financial statements** – In line with the forthcoming Sustainability Disclosure Requirements on private institutions, local authorities should also be required to assess the financial risks of the transition to net zero and impacts of a changing climate on their operations and area. This would increase the overall 'investability' of the Councils and areas by the private sector, and access to capital, to ensure that the local authorities are managing the financial risks of the transition to net zero and physical risks of climate change to their own operations.
- **Implement green budgeting approaches for Local Authorities** - The budgeting approaches for Local Authorities should be updated to implement climate budget tagging. This would enable Local Authorities to systematically manage their budgeting decisions through a climate lens. Such practices are becoming common in other jurisdictions[8], and bring a host of benefits, such as raising awareness, transparency, prioritisation and facilitating trade-offs[9]. However, it is possible that this may also highlight additional spending requirements on the pathway to net zero.
- **Review the potential contribution of environmental taxes to net zero** – The use of penalty charges from Low Emissions Zones under the Transport (Scotland) Act 2019 is a recent example of a ringfenced revenue stream which can be used to support investment in the scheme's objectives. A broader review of the potential contribution of environmental taxes and revenue streams, and their potential contribution to Local Authority finance would allow Local Authorities a 'menu' of choices to support, based on local need and citizen preference.
- **Provide a programme of capacity building and support to Local Authorities.** Whilst the Scottish Government and Local Authorities provide support on mitigation and adaptation, neither focus specifically on climate finance. Both SSN and Adaptation Scotland have begun to explore work
- **Stronger enforcement of supplementary Green Book guidance** on the cost of carbon, and the assessment of impacts of climate change could be used to change investment decisions.

Transformative approaches to accelerating the financing of net zero through Local Government
Whilst the above suggestions are all necessary improvements to the current frameworks and approaches for climate finance, these are incremental approaches within the current system. It is not clear that adopting these approaches will be, in and of themselves, enough to deliver the injection of finance needed at the pace and scale required. In the spirit of the 'kitchen sink' approach required, we also offer one or two wider reflections. These are areas which we feel merit further exploration. They are potentially transformational but require careful consideration on their use and implementation, so we would advocate for studies on the below:

Changing the purpose and direction of local government

- Local Government was not originally conceived as the vehicle for tackling the net zero, climate resilient transition. As such it is likely that structural and institutional changes will be needed for such delivery to be facilitated well.
- This is also true to financing, and there is the potential to look at more structural reforms to accelerate the deployment of climate finance and climate action. For example, Scottish Government could make the Local Government block grant conditional on the transition to net zero and climate resilience.
- This could involve adjusting overall allocations based on the extent to which Local Authorities are prioritising a just approach to net zero and adaptation, the progress they are making, and the financing need given local conditions.

The use of monetary policy to accelerate net zero through currency issue

- Notwithstanding the above areas for improvement, the collective limitations of Scottish Government and Local Government as currency users creates an impetus to push the costs (risk and reward) of the transition into the private sector, and onto households. It also constrains the ability of the public sector to translate the urgency demanded by the science into action at appropriate pace and scale.

[8] See for example, pilot work done in work: https://www.i4ce.org/go_project/framework-for-assessing-the-climate-impact-of-cities-budgets

[9] https://www.i4ce.org/download/environmental-budget-tagging-climate/

- Modern Monetary Theory highlights that a country's spending isn't and shouldn't be equated with household's budget and spending programs[10], and that it is possible for the UK Government to spend with taxing or borrowing, given their role as a currency issuer, as happened during the 2008 financial crisis and the COVID-19 pandemics[11].
- As a currency issuer, the UK Government has the flexibility of using monetary policy to create a significant capital injection into public sector net zero (e.g. through the creation of Gilts).
- The UK Government has already begun establishing a framework for this to happen, through the Green Financing Framework, which has already mobilised over £16bn for public sector investment in net zero and adaptation through National Savings and Investment products and Green Gilts [12].
- There is the potential to combine or extend the two to provide Local Government with a significant capital injection which could be used to accelerate the transition, and secure the capital needed for first-mover advantage. It could also 'de-risk' the political challenges of the transition, given likely citizen resistance to additional costs from the transition to net zero, when set against rising energy prices and broader increases in the cost of living.
- However, there are valid concerns with this kind of demand-side approach, which should be explored and understood, notably the effect of this on inflation and the labour markets.

[10] Kelton, S. (2021) *The Deficit Myth: How to build a better economy.*
[11] To date the current amount of money injected into the UK economy this way stands at £875bn: https://www.bankofengland.co.uk/monetary-policy/quantitative-easing
[12] HM Government (2021) *Green Financing Framework*. https://www.gov.uk/government/publications/uk-government-green-financing