Ambition, Action and Accountability:

Building on the UK's leadership on Transition Plans to shape a policy response to the US Inflation Reduction Act

An Aviva climate policy white paper

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Summary

- **Aviva is pursuing one of the most ambitious carbon reduction plans of any major insurer, with an ambition to become a Net Zero carbon company by 2040.** In 2022 we published the first release of our Climate Transition Plan setting out the steps we'll take to achieve this.
- **The UK has a strong record on climate policy**: innovations such as carbon budgets and Climate Change Committee (CCC) are the envy of other major economies and have enabled us to decarbonise faster than our G7 counterparts.
- However, **the scale of private investment mobilised by the US Inflation Reduction Act (IRA), combined with the lack of policy certainty in key sectors in the UK, risk the UK being left behind** in terms of investment opportunities for the green transition.
- In the near-term, the Government should **use the Autumn Statement to focus a limited amount of fiscal firepower on areas where low carbon investment is facing market barriers due to the complexity of these sectors.**
- In the medium term, we propose that **the Government releases a clear and comprehensive UK Climate Transition Plan.** This would build on the current Net Zero Strategy and Carbon Budget Delivery Plan, plugging public policy gaps in key sectors and giving clear direction to investors and the private sector.
- Thanks to strong government leadership, **Transition Plans are increasingly being used by UK private sector firms** to set out their pathways to net zero in a clear, comparable and consistent fashion. A UK Climate Transition Plan should mirror the principles of the private sector TPT framework and:
    - Cover **all key forms of intervention** – tax, spend and regulation (see **Box A**)
    - Cover **all key economic sectors**, including energy, transport, heat and agriculture
    - Be **periodically updated and disclosed in a consistent fashion** – so stakeholders can take a view on its credibility and deliverability
    - Be at the heart of a **structural reform of UK climate policy governance**, which would increase accountability and delivery of climate policy (see **Box B**)
    - Recognise the integral role of HM Treasury in delivering net zero and thus create a genuinely **Green Treasury** (see **Box C**)
- Collectively, these changes would:
    - **Retain and enhance UK competitiveness** in the face of increased international action on climate
    - **Attract green investment without having to make big spending commitments** by giving greater clarity, consistency and certainty to investors about the UK's policy pathway to net zero
    - **Re-enforce the UK's position as a global leader on climate**
    - **Increase democratic scrutiny** and accountability of climate policy

1. Investors are calling for an urgent response to the US Inflation Reduction Act and other emerging global climate measures

1.1 Aviva is pursuing one of the most ambitious carbon reduction plans of any major insurer, with an ambition to become a Net Zero carbon company by 2040. In 2022 we published the first release of our Climate Transition Plan, setting out the steps we'll take to reduce emissions to Net Zero in our operations and supply chain by 2030, and in our investments and underwriting by 2040. We recognise that climate change is an existential issue for our industry, our customers and their families.

1.2 We have been able to set these ambitions in part due to the significant progress made by government in transforming the wider UK economy – cutting carbon emissions by 48% since 1990 whilst growing the economy by 65% . However, progress in advancing the UK's green economy is now stalling, which in turn risks Aviva's, and all other private sector actors, ability to meet net zero goals.

1.3 The UK is not "climate-ready" and is falling behind the US and EU in terms of green investment, jobs and growth:

- The UK is not on track to meet its net zero targets or prepared to adapt to the impacts of climate change – even under the government's own assumptions
- Significant investment is needed to close the gap; however the UK, like many other countries, is feeling the effects of global economic headwinds which have put pressure on public finances
- Businesses are looking for opportunities to invest which has the potential to narrow the climate funding gap and grow the economy, yet they lack the certainty needed to direct this investment
- Consequently, they are increasingly looking elsewhere to invest. In the seven months since the Inflation Reduction Act passed, clean energy companies in the US have announced over 100,000 new jobs across 31 states , compared to the 11,500 estimated jobs that have been created in the low carbon sector in the UK since 2014

1.4 The UK is not currently taking the necessary steps to drive private sector investment into net zero – the 2,800+ pages of March 2023 climate and energy announcements:

- Included almost nothing in the way of new tax, spending or regulatory commitments
- Did not provide the investment roadmaps required to unlock private investment in net zero, and
- Did not include adequate structural reforms to oversee net zero delivery within government

1.5 By failing to act comprehensively at scale the UK is exposed to the risks of climate change while simultaneously losing out on the economic opportunities presented by the global race to transition: green jobs, growth and reduced inflation and cost of living pressures. If we do not act quickly and with ambition, we will consign ourselves to the worst of both worlds.

1.6 Aviva stands ready to allocate even more capital towards building the UK green economy, but we need more long-term policy certainty from Government to allow us to do so.

2. The UK response to the US Inflation Reduction Act should take the best of what is working in the US while building upon UK-specific advantages

2.1 While the UK cannot match the size of the fiscal incentives provided by the US, there is a strong case for advancing funding mechanisms such as subsidies, taxes or other financial incentives, alongside wider decarbonisation measures, such as policy signals, in order to remain competitive in the green economy.

2.2 What we should take from US approach:

- High level of ambition and long-term thinking (while noting that our public spending firepower is more constrained)
- A focus on real economy transitions, incentivising investment in specific green industries, and creating green jobs
- Ensuring domestic global competitiveness when it comes to green industries
- Place-based approach explicitly using green investment to generate green jobs and revitalise regions, fostering local R&D/ innovation
- Long term commitments combined with accountability across government and leadership from the Treasury, as the department which holds the levers needed to unleash the potential of private sector investment

2.3 In addition, the UK:

- Can look across entire policy lever spectrum (the US is politically more limited in terms of tax/ regulatory changes),
- Has greater political consensus and public buy-in on climate action
- Has more experience than the US when it comes to climate / low carbon policymaking, including in carbon budgeting and transition planning at private/ public levels
- Can build on our strong foundational strategies and policy/regulatory frameworks already in place
- Has an opportunity to use the capital framework to incentivise green investment from asset owners

2.4 We therefore recommend a twofold approach:

- A near-term public funding response in this year's Autumn Statement that helps crowd in private investment in parts of the economy where low carbon investment is struggling to take off; followed by
- A comprehensive public policy plan - with supply side and demand side regulatory and fiscal measures - which can help drive long-term and cost-effective private investment in zero carbon solutions

3. In the near-term the Government should focus its fiscal firepower

3.1 The Autumn Statement provides the Government with its first opportunity to start responding to US IRA and the EU Green Deal Industrial Plan by putting forward meaningful and targeted public funding to accelerate investment in the UK's net zero transition.

3.2 Recognising that the UK Government does not have the same fiscal bandwidth than the US Government, the use of public funding should be targeted in priority at those sectors of the low carbon economy where barriers to investment exist, either because the technologies involved are still emerging and seen as riskier by investors (such as the development of new green steel or cement plans) or because projects are logistically complex (the difficulties in retrofitting and decarbonising the UK housing stock is a good example here).

3.3 There is also a case for public funding to be targeted at critical infrastructure that is core to enabling the decarbonisation of several sectors of the economy; the reinforcement and extension of the power grid being a good example here.

3.4 In practice and when it comes to the Autumn Statement, we would therefore envisage that meaningful but targeted public funding could be directed towards critical underlying infrastructure such as the extension of the power grid, low carbon investments in emerging technologies in hard to abate sectors (such as steel, cement, chemicals, glass, heavy goods transport and shipping) and towards technologies and solutions in sectors that are logistically complex to decarbonise (such as the accelerated roll-out of energy efficiency measures and electric heat pumps in homes).

4. A whole of economy UK Transition Plan would unify and drive the UK's climate policy framework, and give business greater certainty to invest

4.1 Since 2022, Aviva has co-chaired the Transition Plan Taskforce (TPT) with HM Treasury, helping set the standard for large UK companies to disclose against.

4.2 The UK is leading the development of global standards on sustainable finance, particularly on transition plans via the TPT's alignment with GFANZ (where Aviva also co-led transition planning work) and the UK Government's advocacy of the TPT framework internationally.

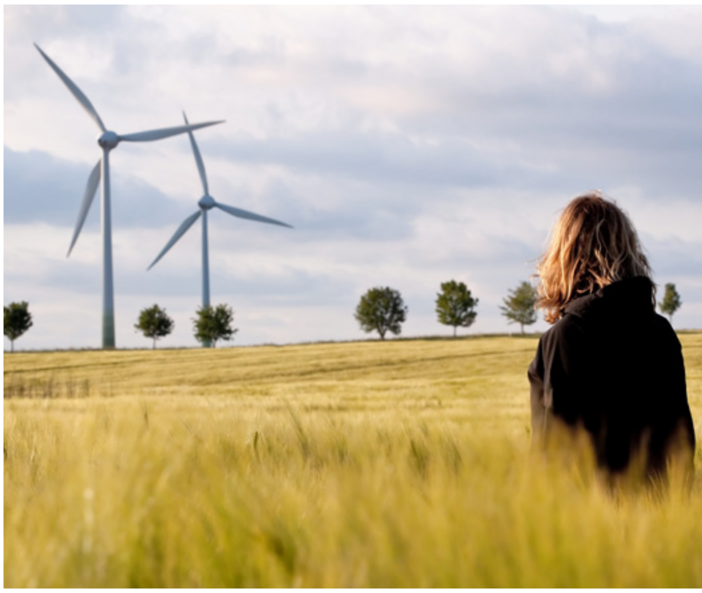
4.3 The regulatory framework for firms is being built, but corporate transparency is only one part of the solution – as it takes place within the overarching framework of government policy which dictates the speed of the transition. Ultimately, UK businesses and investors' Transition Plans will only be effective if the Government's own public policies that drive investment in the real economy are sufficiently clear, credible and certain. We require a clear, long-term policy framework in place to provide investors, like Aviva, with the certainty and direction needed to allocate resources.

4.4 We therefore believe the structure and rigour of the transition plan framework developed by the TPT for corporates would also be helpful as a shaping device for the public sector – notably Governments, but also including multilateral institutions such as the World Bank, IMF and international standard setters. When all key public and private actors adopt a transition planning approach, we should be able to generate positive feedback loops whereby government climate policy both incentivises and is informed by private actors.

4.5 A whole of economy UK Transition Plan, as recommended in Chris Skidmore's Independent Net Zero Review, would reframe and build on the existing Net Zero Strategy and Carbon Budget Delivery Plan in a way that aligns with the robust framework set out by the TPT. It would help to identify policy and investment gaps, as well as opportunities for green growth. To match the opportunities presented within the US IRA, it should have embedded within it measures such as real economy decarbonisation pathways, investment roadmaps, and targeted incentives.

4.6 Being the first to adopt and disclose such comprehensive plans as a Sovereign debt issuer would be pioneering and position the UK as a global leader in delivering the net zero transition.

4.7 In our recommendations below, we apply the core principles (Ambition, Action and Accountability) of the TPT framework to the UK policy context and set out a framework for delivery in the UK.



Box A
Ambition and Action: A UK Climate Transition Plan

1. We recommend the government releases a clear and comprehensive **UK Climate Transition Plan** which updates and builds on the current Net Zero Strategy. This should cover:
   a. **tax** and other carbon pricing incentives, e.g. commitments to:
      i. a wholesale review of the tax system to consider how it could better align with the net zero goal while lowering the cost of living for individuals
      ii. keep the emissions trajectory under the UK ETS under review to make sure that the carbon pricing signal is sufficiently high
      iii. look for regular opportunities to broaden the UK ETS to other sectors
      iv. extend the emissions trajectory under the UK ETS out to 2050
      v. update the proposed UK Carbon Boarder Adjustment Mechanism, working with G7 countries to work towards a consistent approach
   b. **regulatory** interventions, e.g.:
      i. New or strengthened commitments to phase out high emitting activities and/ or phase in low carbon technologies
      ii. Low carbon product standards and affordability measures
      iii. Ensuring the regulatory capital frameworks support long-term green infrastructure investments
      iv. Updating Directors Duties
      v. Integrating climate requirements into financial advice
   c. **spending** commitments, e.g.:
      i. a targeted programme of spending to incentivise/ support the growth of green industries which supports existing targets while increasing energy security and helping citizens tackle the cost of living
      ii. a green investment plan setting out how public/ private finance will pay for necessary policies
      iii. Further alignment of existing forms of Government spending with net zero – eg procurement, export credit, ODA
2. This should cover real economy decarbonisation across all key sectors, notably –
   a. **Energy** e.g. speeding up planning for renewable infrastructure
   b. **Transport** e.g. new commitments to enable delivery of ICE phase out by 2030
   c. **Heat** e.g. providing clarity on the future of low carbon heating technologies
   d. **Land use/ agriculture** e.g. spatial prioritisation, with a focus on agricultural productivity, forestry cover and peatland restoration
3. These policy interventions must:
   a. **Set out short, medium and long-term measures** to give clarity and certainty
   b. **Collectively add up to a credible emissions pathway** to meet future carbon budgets and the ultimate 2050 net zero goal; and
   c. **Be prudent** in assumptions (e.g. not overly rely on a single technological breakthrough), building in contingencies
   d. **Link to regional and local transition plans** that highlight local strategies to deliver national goals
4. Accompanies the Plan with, on the day of release, joint independent analysis by the Committee on Climate Change and OBR on the climate and economic impacts of the policy changes planned.

Box B

Accountability: Structural Reform of UK climate policymaking

Aviva's net zero by 2040 ambition is contingent on the broader UK economy decarbonising by 2050. However, by the government's own analysis and that of the CCC, the UK is not on track to meet this target.

The most effective way to ensure long term policy outcomes beyond electoral cycles is to create strong institutional incentives for success – notable examples include granting independence to the Bank of England in setting monetary policy and the creation of the OBR.

The publication of the first UK Climate Transition Plan should therefore be accompanied by an ambitious and comprehensive package of **structural reforms of UK climate policymaking** to give greater certainty of delivery to businesses, investors and the public as whole.

Key features should include:

1. A requirement on Government to annually **update Parliament and report against delivery of all elements of the UK Climate Transition Plan at all key annual fiscal events**, accompanied by <u>simultaneous</u> analysis by a joint CCC/ OBR team. This would develop the existing accountability and make it more timely without being onerous.
2. **Updating HM Treasury's organisational responsibilities at the highest level to include the delivery of net zero** – thereby providing formal responsibilities for officials and Ministers to consider the impacts of economic and fiscal decisions on the UK's legally binding net zero commitment (see Box C).
3. Giving the Bank of England, Financial Conduct Authority and other relevant financial and environmental/ energy regulators an **explicit statutory objective to support the UK's net zero commitment**, ensuring financial regulation and enforcement take account of the UK's net zero and environmental aims.
4. All departmental **Outcome Delivery Plans to include an objective on facilitating and aligning to net zero,** covering policy decisions alongside operational emissions.
5. The creation of a **Joint Net Zero Delivery Unit**, sitting within the Cabinet Office, HM Treasury and DESNZ and co-chaired by the DESNZ SoS and the Chancellor to coordinate and enforce items (i) – (iv) above, as well as other cross-Government work on net zero, and including external independent representation (eg the CCC) alongside Ministers and officials.

Ideally, these structural climate policy reforms should ultimately be **explicitly embedded in an update to the Climate Change Act** – though they could be made initially within the scope of existing legislation.

Box C

A Green Treasury

HM Treasury (HMT) is the single most influential organisation in the country in setting financial and economic policy. **If we are to deliver net zero in the UK and globally, the core policy levers at HM Treasury's disposal need to explicitly support delivery of net zero.**

Several countries, including the US, have given their Treasuries **climate mandates** at the highest level of governance/ objectives. Others, including Germany and the Netherlands, have now **formally integrated climate action within their Economic Ministries** – both countries now have combined Ministries for Climate and Economic Affairs. Finland's Finance Ministry has made a **comprehensive review of how core Finance Ministry policies (namely, tax, spending and financial regulation) must align to net zero and nature targets**.

In comparison, climate change and net zero **do not feature in HMT's current "priority outcomes"**: in its latest delivery plan HMT is only listed as "contributing" to a net zero outcome owned by BEIS (now DESNZ), with no accompanying detail as to how it will make such a contribution via core HMT policies.

Without a change to structural incentives and oversight there is a risk that, despite climate change being the single greatest threat to sustained economic growth, other priorities will take precedence over climate policy in the Treasury's decision-making.

To remedy this and follow international best practice, we recommend HMT:

1. Updates HMT's organisational delivery plan to **include net zero as its own priority outcome.**
2. As a matter of urgency, **re-examines tax, expenditure and regulation through the lens of net zero alignment** and make any necessary revisions at the next possible fiscal event as per Box A above.
3. Reform HMT's organisational structure to **integrate net zero alignment across all core functions:** notably tax policy creation, public spending, financial regulation and economic forecasting.
4. **Continually review the climate impacts of all tax and expenditure changes** at subsequent fiscal events and disclose these at fiscal events, along with independent analysis by the CCC/OBR.

5. Conclusion: planning for climate leadership at home and abroad

5.1 The package of measures outlined above would regain lost ground on climate policy and place the UK once more at the forefront of climate action internationally.

5.2 It would provide a framework to **enable the UK to better compete with the US** and **attract long term private sector investment in green industries without placing sole focus on expenditure** and subsidies at a time when UK fiscal firepower is limited.

5.3 In the spirit of enhancing global action on net zero, we should use this position to encourage other countries and key global institutions to follow the same approach - setting transition plans with structure, rigour and accountability.

5.4 This could form a key plank of future technical assistance for developing countries and emerging economies, as well as shaping device and outcome for current discussions on international financial architecture reform.

5.5 Clearly, it will be vital that the individual policies that underpin a UK-wide Climate Transition Plan are sufficiently ambitious. With this in mind, Aviva Investors is preparing a Net Zero Policy Roadmap summarising key public policy interventions that are required to plug existing policy gaps on net zero.

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