

The role of natural capital in the green economy

Positive Money submission to the Environmental Audit Committee's inquiry into the role of natural capital in the green economy.

Positive Money welcomes the opportunity to respond to the Environmental Audit Committee's call for evidence on the role of natural capital in the green economy.

We are a not-for-profit research and campaigning organisation, working towards reform of the money and banking system to support a fair, democratic and sustainable economy. We are funded by trusts, foundations and small donations.

Contact: ellie.mclaughlin@positivemoney.org.uk

Our submission makes the following key points:

- Private finance can play an important role in securing nature recovery, but there are significant challenges in creating profitable investment opportunities from projects that deliver genuine nature recovery.
- Market-based approaches to nature restoration can create perverse incentives that may reduce positive impacts on nature, and require robust regulatory oversight and enforcement.
- Increased public investment is therefore critical for the government to achieve both domestic and international nature recovery targets.
- The private investment industry and banking sector are currently financing nature-destructive activities at scale, undermining the government's ability to achieve nature recovery goals.
- Alongside increasing public investment in nature, action to redirect private investment away from harmful activities and towards nature and climate aligned sectors and activities must be prioritised.
- To be effective, actions to align financial flows in line with nature goals must move beyond the current risk-based approach which focuses on disclosure and voluntary action, and towards actively steering investments, such as through credit guidance policies.

1. What potential contribution can private capital investment make to measures to secure nature recovery?

1.1. **Achieving the government's nature recovery goals will require a substantive increase in investment, however the scale of financing needed is subject to significant uncertainty.**

The Environmental Audit Committee is right to examine the potential future role of natural capital in the green economy and the government's proposals to increase private investment in support of nature recovery. It is clear that there is a significant shortfall in funding between

present commitments and what is required to meet the UK's domestic and international nature recovery targets. Estimates from the Green Finance Institute (GFI) suggest that as of 2021, planned spending to meet domestic targets falls approximately £56bn short of what is needed for the UK to meet its targets by 2030¹. However, it is important to note that the required funding to meet nature recovery goals is likely to be highly dependent upon the strategy for nature recovery chosen. The estimates made by the GFI, for instance, notably include substantial land acquisition and financing costs, whilst excluding any gains investors may receive from asset price appreciation². At an international level, the Paulson Institute estimates the global biodiversity financing gap to be US\$ 711 billion³, which likewise includes costs for land acquisition and protection. Therefore, it is likely that the scale of the financing gap may be reduced significantly through optimising public investment and regulations on land use⁴.

1.2. **Reliance on voluntary private capital investment is unlikely to be the most effective means of funding nature restoration.**

There are significant challenges to effectively mobilising private capital at the scale of investment needed to secure nature recovery - both domestically and internationally - through voluntary, market-based approaches. Institutional investors, such as pension funds, asset managers and insurers, require investment opportunities to meet several criteria when allocating funds, which are rarely met by nature-based assets. This includes most importantly providing returns that are competitive with alternative investment opportunities and large transaction sizes, as well as providing standardised investment terms and liquid secondary markets⁵. The inherent and unique complexity of nature means that designing investment vehicles that meet these requirements is incredibly complex. Returns are often uncertain and long-term, and transaction sizes often small. The significance of these challenges is reflected in the failure of private markets for natural capital to scale-up and to sufficiently address the biodiversity crisis thus far, and the ongoing reluctance of the private sector to invest in nature restoration projects⁷. The European Investment Bank's recent analysis of financing for over 1,300 nature projects across the EU revealed that 97% of projects received no significant support from the financial sector⁸.

Research also suggests that there tends to be a trade-off between financial returns from privately financed biodiversity projects and biodiversity impact⁹. Whilst private capital requires competitive returns to make investment viable, effective governance and oversight of nature restoration schemes raises costs, creating incentives to reduce governance and ultimately lower environmental outcomes in the aim of creating 'investable' opportunities. In

¹ GFI, etec, Rayment Consulting (2021). [The Finance Gap for UK Nature.](#)

² Hollingdale, J. (2023). [The Credibility Gap for Green Finance.](#)

³ Deutz et al., (2020). [Financing Nature: Closing the Global Biodiversity Financing Gap.](#)

⁴ Macfarlane, L. (2023). [Is the finance gap for nature really £20bn?](#)

⁵ Kedward et al., (2022). [Nature as an Asset Class or Public Good? The Economic Case for Increased Public Investment to Achieve Biodiversity Targets.](#)

⁶ Financing Nature Recovery UK (2022). [Part A: Barriers to investment and the role of markets for nature.](#)

⁷ WWF UK (2022). [Nature Based Solutions - a review of current financing barriers and how to overcome these.](#)

⁸ EIB (2023): [Investing in nature-based solutions: State-of-play and way forward for public and private financial measures in Europe.](#)

⁹ Flammer et al., (2022). [Biodiversity Finance.](#)

the case of the Woodland Carbon Code - one of the UK's largest nature markets - carbon brokers have noted that it is often more difficult to create carbon credits via natural regeneration of woodland, due to the uncertainty inherent in natural regeneration - incentivising plantation forestry despite poorer biodiversity outcomes¹⁰.

Extensive research documents how market-based nature projects have to date routinely under-delivered according to nature protection and/or restoration goals. Failures in the design of Australia's New South Wales biodiversity offset scheme, for example, led to the scheme severely under-delivering on nature outcomes¹¹.

Financialised nature recovery initiatives can also generate other undesirable outcomes, by incentivising speculative activities and driving up land prices, and by negatively impacting local communities. Accelerated demand for agricultural land in Scotland, largely driven by demand for carbon offsets from institutional investors, led to the value of land with afforestation potential increasing by over 60% in 2021 alone¹². Due to the perverse incentives embedded in market-based approaches to nature restoration, public funding must play a more central role. In order to achieve domestic targets, increased funding should be given to grant-based programmes such as the Nature for Climate fund and the Environmental Land Management Schemes (ELMS), with new forms of funding established.

1.3. Natural capital initiatives are prone to trade-offs and greenwashing.

Any initiatives pursued must be subject to strict regulatory oversight, with public investment, for example through the UK Infrastructure Bank (UKIB), taking a leading role. Due to the challenges described above, nature markets require strict regulatory oversight for genuine benefits for nature to be delivered and to prevent adverse impacts on land prices and local communities. Regulation of such markets is complex, due to the unique challenges in establishing standardised data and metrics for nature which poses significant risk of greenwashing¹³. In light of this, an overly heavy reliance on private capital investment threatens the UK's ability to meet environmental goals.

The UKIB, which made its first natural capital investment of £12 million in the Tayvallich Estate nature restoration in the Scottish Highlands in March this year¹⁴, is well placed to play a central role in investing in market-based natural capital approaches to the extent that they may play a role in nature restoration. Indeed, the UK Infrastructure Bank Act includes nature-based solutions within its definition of infrastructure¹⁵. With a longer time horizon, greater risk tolerance and ability to accept lower returns than private investors, investment via the UKIB could mitigate some of the trade-offs, uncertainties and perverse incentives that plague natural capital projects. This may be best achieved via equity stakes rather than debt-based financing for nature projects, putting less pressure on projects to make repayments and giving the UKIB the opportunity to play a more active role in project governance and oversight.

¹⁰ Stanley, S. (2023). [Reforestation Scotland](#).

¹¹ Cox, (2022). ['Utterly damning' review finds offsets scheme fails to protect NSW environment](#).

¹² Reed et al., (2022). [Large-scale land acquisition for carbon: opportunities and risks](#).

¹³ Jones, H. (2023). [EU watchdog monitors surge of cash going into biodiversity funds](#).

¹⁴ UKIB (2023). [At the forefront: Pioneering new approaches in Scotland's natural capital markets](#).

¹⁵ [UK Infrastructure Bank Act \(2023\)](#).

2. How can investment best be aligned with environmental benefits, so as to achieve or surpass the government's targets for nature recovery?

2.1. The investment industry is heavily financing activities driving both the climate crisis and nature-destruction, undermining the government's targets.

The investment industry, and the wider financial sector, are at present driving climate change and nature-destructive activities at an unsustainable level. This must be urgently halted in order to meet both domestic and international climate and nature recovery goals. Whilst the UK committed to halt and reverse forest loss and land degradation by 2030 as part of the Glasgow Leaders' Declaration on Forests and Land Use¹⁶, Global Witness estimate that UK banks and asset managers provided approximately \$16.6 billion to businesses implicated in deforestation between 2015-2020¹⁷. Similarly, Make My Money Matter estimate that £300bn of UK pensions are invested in companies and financial institutions driving deforestation¹⁸. Investors are not voluntarily taking action in line with meeting government goals. ShareAction find, for instance, that almost 75% of the world's largest asset managers - many of which manage UK pension fund assets - have no commitments on ending deforestation¹⁹. Aligning investment with environmental benefits therefore requires not only creating new investment opportunities, but crucially, rapidly reorienting investment away from harmful activities and towards desirable ones - interventions that are currently lacking in the UK's Green Finance Strategy²⁰. Such interventions should be integrated with, rather than separate to, climate goals.

- 2.2. **Policy must move beyond voluntary private sector action and the creation of investable nature-recovery initiatives, and address the fundamental drivers of biodiversity loss by actively steering financial flows away from undesirable activities and towards desirable ones**

Regulation to divert finance away from destructive activities

- 2.3. **Nature should be incorporated into net-zero transition plan requirements, which should be made mandatory for all financial institutions, public and private companies, going beyond the current 'comply or explain' approach.**

The government's recent commitment in the 2023 Green Finance Strategy to consult on disclosure of transition plans by large companies, as an extension of the FCA's current requirement of listed companies, is welcome²¹. However, the FCA's current "comply or explain" basis for the disclosure of transition plans does not amount to the government's COP26 commitment of mandatory disclosure²². Given the interdependencies of climate

¹⁶ HM Government (2023). [2030 Strategic Framework for International Climate and Nature Action](#).

¹⁷ Global Witness (2021). [Deforestation Dividends](#).

¹⁸ Make My Money Matter, Systemiq and Global Canopy (2021). [Cutting Deforestation from our Pensions](#).

¹⁹ ShareAction (2023). [Point of No Returns 2023. Part IV: Climate and Biodiversity](#).

²⁰ Positive Money (2023). [New Green Finance Strategy silent on winding down fossil fuel finance, say experts](#).

²¹ HM Government (2023). [Mobilising Green Investment: 2023 Green Finance Strategy](#).

²² HM Government (2021). [Fact Sheet: Net Zero-aligned Financial Centre](#).

change and nature, it makes sense for both to be integrated in transition planning. Across the board, transition plans should be aligned with a 1.5C and nature-positive transition. Whilst the most recent draft transition plan disclosure framework states that transition plans should cover ‘measures to address material risks to, and leverage opportunities for, the natural environment’²³, in order to align with international commitments on nature recovery, transition plans should require companies and financial institutions to align portfolios with the Kunming-Montreal Global Biodiversity Framework²⁴.

2.4. Give financial regulators statutory mandates on climate and nature.

The Green Finance Strategy recognises the role of financial regulators in supporting the UK’s climate and nature 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’²⁵. Forcing regulators to prioritise the competitiveness of the UK’s financial sector risks undermining the robust regulation needed to align finance with environmental goals. The government should instead give financial regulators statutory objectives for net zero alignment and nature protection, to ensure that the regulatory framework supports nature recovery and net-zero goals.

Measures to reduce the cost of green credit

2.5. The government must move past disclosure and market-based frameworks and coordinate monetary and fiscal policy to actively shift financial flows in line with both climate and nature targets.

To align investment, the UK’s green finance regulation must move past the assumption that financial institutions will become aligned with net zero and nature goals through financial risk-based disclosure regimes and voluntary initiatives. This is insufficient to change investment behaviour, account for market failure, and shift financial flows from fossil fuels and towards greener alternatives.

The government should coordinate²⁶ with the Bank of England to directly reduce the cost of credit for activities aligned with a climate and nature-positive transition:

- Restrict investment in activities that are incompatible with climate and nature goals.
- Use targeted lower interest rate lending schemes to lower the cost of capital for the transition²⁷.

Questions 3, 4 not answered.

²³ Transition Plan Taskforce (2022). [Consultation: The Transition Plan Taskforce Disclosure Framework](#).

²⁴ CBD (2022). [Kunming-Montreal Global Biodiversity Framework](#).

²⁵ Finance Innovation Lab (2022). [Why ‘competitiveness’ objectives for regulators risk UK finance success](#).

²⁶ Positive Money and NEF (2021). [Greening Finance to Build Back Better: A UK roadmap ahead of COP26](#).

²⁷ NEF (2021). [Green Credit Guidance: A green term funding scheme for a cooler future](#).

5. How can the proposed UK Green Taxonomy support high-quality investments which deliver genuine benefits to nature? What financial disclosures should the taxonomy require?

5.1 The proposed UK Green Taxonomy must be science-based, and extended to define not only ‘green’ activities but also ‘dirty’ activities.

We welcome the government’s announcement in the Green Finance Strategy that natural gas will not be included in the UK’s Green Taxonomy, which they plan to consult on in the autumn of 2023. To enable regulators to steer financing away from detrimental climate and nature impacts, a comprehensive taxonomy that goes from green to dirty (identifying activities incompatible with net zero and nature goals and where managed exit is required), including shades of both, is crucial²⁸. Whilst the EU taxonomy’s labelling of natural gas as a ‘transitional’ activity undermined its credibility, the UK taxonomy doesn’t need to repeat this mistake. The government-supported Green Taxonomy Advisory Group’s (GTAG) have supported moving towards an extended taxonomy, stating that developing an ‘amber list’ and ‘red list’ of transitional and harmful activities are high priorities. GTAG also propose that in the short-term, the government should legislate to phase-out harmful activities²⁹.

²⁸ Positive Money and NEF (2021). [Greening finance to build back better: a UK roadmap ahead of COP26.](#)

²⁹ GTAG (2023). [Developing a UK taxonomy adapted to the UK’s needs in the short and medium term: Scope, coverage and reporting considerations.](#)