

Green Investment Bank – catalyst or fig leaf?

At long last some flesh is starting to adhere to the bones of the Green Investment Bank (GIB) that was a centre-piece of the coalition commitments when the government was formed in May 2010. The idea of the GIB is one of the foundations upon which Prime Minister David Cameron built the claim that his would be “the greenest government ever.”

Early indications of what the GIB might look like and how it will operate were sketchy and decidedly meagre. The bank’s initial endowment of public funding was to amount to just £1 billion, to be funded out of sales of government assets. That left most of us involved in infrastructure investment underwhelmed. Set against the UK’s infrastructure investment needs this sum looks trivial. For example, it is forecast that the energy sector alone needs some £200 billion of investment in new low-carbon generating capacity by 2020 in order to ensure security of supply and meet targets for the reduction of carbon emissions. In the transport sector, a single project, the proposed high speed rail line from London to Birmingham and the north, is said to be likely to cost over £30 billion.

Subsequently, through the Comprehensive Spending Review in October 2010 and the budget in March of this year, a bit more substance was revealed and the government moved to ensure that the GB would have some additional resources. Its initial capitalisation was increased to £3 billion, still funded through asset sales. This led some to question the extent of the government’s commitment since asset sales are an inherently uncertain source of revenue. For example, the proceeds of the sale of the Tote, the government-owned on race course betting organisation, are expected to go to the GIB. Yet the price that the government has obtained (£265 million), is substantially was projected when sale of the Tote was first mooted a few years ago and the structure of the deal means that only about £90 million actually will go to HM Treasury for possible injection into the GIB. Selling at a low point in the economic cycle ultimately may come to be seen as poor value for money in endowing the bank.

Another issue is that the GIB will be publicly owned. This means that any debt it incurs will count towards overall government borrowing. At a time when the single most important priority for government is to drive down borrowing in order to reduce the deficit this, in turn, means that in the short term at least the GIB’s commercial freedoms will be severely constrained in order to meet Treasury priorities. Thus, the bank will not be given borrowing powers until 2015 – ie after the current spending round and at the point when the government hopes that the deficit issues will have been dealt with. (And even then, only if borrowing is falling as a proportion of GDP.)

These concerns about the GIB have been summed up by Jonathan Porritt in his report for Friends of the Earth entitled “*The Greenest Government Ever: One Year On*”. The report provides the most comprehensive audit yet of the government’s delivery on its green commitments. Given its provenance, one would expect it to find failures and shortcomings. Interestingly, though, Porritt’s conclusions do not rely solely on his own assessment: he frequently cites independent authorities, often within the business community which might be expected to be inherently more cautious on these issues.

His overall conclusion on the government's record on sustainability makes clear the politics at work within the coalition. He says:

“It is hard to find substantive evidence of the Prime Minister using any of his personal political capital to promote more sustainable outcomes off the back of the coalition agreement. Most of the important battles (on the Green Investment Bank, for example) have been lost, and the predominantly hostile orientation of ministers like Eric Pickles, Michael Gove, Francis Maude, Andrew Lansley and George Osborne has clearly established what can only be described as ‘default negativity’ regarding sustainable development in this government.”¹

On the specific details of the government's position with regard to the GIB, Porritt says:

“Although the Green Investment Bank has been welcomed in principle by business and environmental groups, there has been much concern that the Treasury has vetoed plans for borrowing until 2015, on the grounds that any liabilities will appear as part of government debt. ... CBI and many businesses have expressed deep disappointment at Treasury's delaying tactics. It is a particular embarrassment for Chris Huhne, who originally stated that ‘ducks quack, and banks borrow as well as lend’. Furthermore the additional £2bn pledged in the budget will have to be raised through the sale of future assets, including the highly controversial High Speed Two project. Such receipts are highly speculative.”²

Clearly, therefore, the GIB cannot itself take up a significant share of the funding burden. So we need to consider the likely impact of the GIB in the context of rather different considerations. The critical question is: will the involvement of the GIB, even in a small way, be likely to be influential in persuading commercial lenders to free up investment in major infrastructure projects that currently they are unwilling to commit to because the level of risk is perceived to be too high?

The associated question is: if the GIB turns out not to be able to play that catalytic role, will it go for smaller, more ‘innovative’ projects, in effect taking on a technology demonstration role akin to many of the pre-existing government support mechanisms for green technologies?

Deputy Prime Minister, Nick Clegg, gave the government's response to these questions in a recent speech that provided an up-date on government thinking on the design of the GIB. He said:

“There are capital funds that want to invest in the green economy and firms bursting to grow but desperate for funds. The role of the Green Investment Bank is to close the gap

¹ Jonathan Porritt, “The Greenest Government Ever: One Year On”, FoE, May 2011, p 50.

² Ibid, p8.

between the two. Smart investment from the bank will catalyse much greater investment from capital markets.”³

The government says that the initial £3 billion capitalisation of the GIB will be the catalyst to some £15 billion of conventional investor funding for the sector by 2014/15. Clegg went on to say that the bank’s key role resides in “bridging the gap between investor and innovator”. The BIS up-date document explained that this gap often is a result of perceptions of risk “due to incomplete information”.⁴ In this context, the government’s view is that ‘incomplete information’ relates to the lack of track record of innovative technologies.

And therein lies the rub. For most of the carbon reduction challenges that we face there are long-established technologies with proven records in terms of both commercial viability and reliability. The reality is that, if the UK is to meet the very ambitious targets that it has set for itself in terms of de-carbonising the economy (especially its medium-term targets to 2020), it is these established technologies that will deliver the overwhelming bulk of carbon reductions. For conventional lenders risk associated with development of projects based on these established technologies resides in factors much closer to government. They include:

- Regulatory risk, for example in planning
- Policy risk, for example as a result of uncertainty about continuity of direction of travel caused by frequent major policy reviews
- Political risk, for example where conflicts between local aspiration and national need are resolved, with an eye to future elections, in favour of local interests.

Unless the government takes concerted action to address these kinds of risks, ‘green’ investment will not move into the mainstream. This would affect the GIB and severely constrain the contribution it can make. Certainly, the £15 billion of private sector investment that the government hopes the GIB will be able to attract into the sector will depend as much (if not more) on resolving these issues as upon the existence of the GIB. If these risks are not mitigated, the GIB will end up playing a niche role as a market development instrument for emerging technologies that may have the potential to play a part in meeting long-term carbon reduction goals but that will not deliver capacity to meet near-term binding obligations.

Nick Clegg said in his speech “we can only succeed on issues like climate change if we lift our chins and look to the horizon, well beyond the next election. A genuine desire to take a long-term view is one of the things that animates this government.” But as so many authorities are saying increasingly loudly, it is decisions that this government takes between now and the next election that will determine whether the UK is set on a trajectory to achieve meaningful carbon reduction.

³ Nick Clegg, speech to Climate Change Capital, 23 May 2011. The headline points in Clegg’s speech were expanded upon in “Update on the Design of the Green Investment Bank” published by the Department for Business, Innovation and Skills on the same day.

⁴ Ibid, p9.

