Comment

Jibbing at the GIB

The problem with government plans for a Green Investment Bank is that the government itself is involved, says **Michael Mainelli**

I do not question the commitment of Green Investment Bank (GIB) supporters to the environment, but I wonder whether a GIB will achieve what they desire. The economic case for a GIB is money and jobs. "New green technologies represent an important new source of jobs, investment and enterprise… the global market for green technologies and services is already worth $3 trillion per year… the UK has less than a 5 per cent share," according to the launch document of the GIB working group set up by the Conservative Party early last year. In June, the group recommended an Act of Parliament to form a GIB.

Putting aside the political theatre, this initiative claims to address the following market failures:

- market investment capacity limits and limited utility balance sheet capacity;
- political and regulatory risks stemming from the fact that government policy determines expected returns, but there is a history of policy changes;
- confidence gaps among investors given technology risks, lack of transparency in government policy and high capital requirements for commercialisation;
- the challenge of making large numbers of small, low carbon investments attractive to institutional investors.

The working group, chaired by Bob Wigley, former chairman of Merrill Lynch Europe, rightly identified the need to de-risk green investments. It saw policy changes, and the perception of future changes, as the main risk. But a government bank creates more government policy risk and, indeed, it already has done. The bank's timing has ranged from recommendations for a board to be in place by October 2010 to talk of getting under way by 2014. Capitalisation figures were initially around £6bn, then lowered in autumn 2010 to £1bn. Then, in March 2011 we learned: "This Budget announces that the initial capitalisation of the GIB will be £3bn and that the GIB will begin operation in 2012-13." Government participation is supposed to lower risk sufficiently to leverage, in the jargon, £18bn of private investment in green infrastructure by 2014-15. There is even talk of the GIB having borrowing powers from 2015-16.

So why do GIB supporters get a hard ride from City analysts? With private offshore wind investment alone possibly exceeding £30bn, it is difficult to see the GIB making a difference across the many green sectors. In fact, it has already held up investment. A rational investor anticipating a tight general election in 2010 would wait until 2012-14 to see the lie of the land as regards government policy. Why invest now if later investors will get a better deal? Government policy risk since 2010 has increased rather than decreased, with changes to feed-in tariffs and windfall energy taxes highlighting capricious government actions, and amid fears over nuclear policy due to Japan's disaster.

Investors sometimes like to see multilateral investment or development banks as co-investors that help them force governments to stick to policies. But the GIB will hardly be independent, whatever the rhetoric. For a government that has binned regional development agencies and their wasteful investment arms, without many tears being shed, why recreate government investment?

With cries of "we've learned the lessons of the past", it looks as if the execrable history of UK government-directed investment, from aerospace to computing, is about to be repeated. And finally, the GIB is only a bank when it can leverage itself, i.e. create money. But who in the City, or any other market, needs a government-subsidised competitor?

I agree with GIB supporters that government failure to enact its own policies is the distinguishing green investment risk. The Long Finance and London Accord, comprising more than 40 financial institutions, has a simpler, slightly subversive, suggestion. An index-linked carbon bond is a government-issued bond where interest payments are linked to published carbon policy targets. Index-linked carbon bonds would set interest rates by reference to a government's carbon emission targets, tariff feed-in prices, in-country fossil fuel prices or carbon prices. Governments would pay more interest when they missed targets or when relevant green prices were lower than promised. Governments can use the funds for anything – schools, roads, hospitals, paying interest.

The resulting hedge enables more confident investment in projects that pay off in a low-carbon future: if the low-carbon future fails to arrive, the index-linked carbon bond pays a higher return, thus making up for the shortfall in return from the low carbon project. Furthermore, the debt price would provide a constant speedometer about confidence in governments meeting green targets, working as bond-cuffs. It is difficult to see the market failures a GIB addresses but easy to see the government failures that index-linked carbon bonds address. Oh, and with all the government debt being financed, index-linked carbon bonds could be launched in 2011.

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