The case for a British Development Bank

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ONWARD

LEVELLING UP TASKFORCE

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Foreword

We have known that we need to level up regional growth and opportunity for some time. The United Kingdom has for decades suffered from disconnected towns, villages and cities, weak capital formation and an infrastructure financing gap, with knock-on implications for productivity and earnings. The coronavirus crisis has crystallised these problems, in some ways making levelling up harder. But it has also created an opportunity to fix them for the long term. We need a long term strategy to boost investment in regional economic development and leverage much greater levels of private capital in the process.

Regional development spending can support balanced growth in a number of ways. Investment and construction of new assets creates additional jobs and supports supply chains. The planning and development of new infrastructure supports new economic activity by connecting people, making them more productive or supporting agglomeration - whether it is a new train line, better broadband or more power. Development financing for small businesses, as the British Business Bank has shown, can fill the gap left by commercial banks uninterested in expensive, low margin lending. Economic development makes our country a more attractive place to live and do business, and by reducing transaction costs makes Britain a more competitive player in the global economy.

Past experience elsewhere holds lessons for our future. In the last seventy years, Germany has successfully rebuilt its economy and levelled up the regional disparities that emerged following the Second World War and during the occupation of East Germany. It has done so by lending to small businesses and investing in infrastructure development through a development bank, KfW. Since 1991, almost one out of every ten euros invested in East Germany has come from KfW,[1] helping to reduce the gap in disposable incomes between East and West Germany by over 50%.[2] Similar initiatives have proven successful in Japan and Canada. Policymakers in Britain should now consider doing the same.

We propose the creation of a British Development Bank. This new institution would have the political mandate and financial muscle to support business lending and new infrastructure development around the country, crowding in private financing and raising government-backed bonds to fund the green transition, regional growth and the shift to a digital economy. This approach would allow ministers to leverage Britain's financial power, through its patient capital networks and the financial markets in the City of London. Because it would be a bank, with both assets and liabilities, it would do so without adding to the government debt, now over 100% of GDP.

The evidence base for a national development bank is well-established internationally and several of the component parts already exist in the UK, in the form of the British Business Bank and the Commonwealth Development Corporation. What is needed is the political will and the economic imagination to turn these building blocks into a fully fledged development financing institution, replacing some of the financing currently supported by the European Investment Bank. We propose that the British Development Bank is established at the coming Spending Review.

We estimate that with a capital outlay of £4 billion, such a bank would be able to unlock an additional £16 billion of new investment. Based on existing cost-benefit analyses, it could generate up to an additional £4 billion to GDP each year. This would replace the roughly £6 billion of capital funding that the UK previously received through the European Investment Bank and, by incorporating the British Business Bank (BBB) and Commonwealth Development Corporation (CDC), it would streamline Britain's regional funds to reduce complexity and inefficiency. Through the ability to raise bonds it would be self-funding, leveraging private capital and creating an institutional architecture to support SME, infrastructure and wider development finance. We propose that the bank is formally owned jointly by the UK government and the devolved administrations to ensure that the bank is accountable to all regions of the United Kingdom and led by regional reality rather than top-down decision-making.

An additional benefit of establishing a national development bank would be to create a long term financing institution capable of taking decisions away from the political cycle. At present, infrastructure decisions are subject to political wrangling that can frustrate investment and create undue delay. An independent bank, overseen but not controlled by the Treasury, would create certainty and stability of funding, especially for controversial projects.

Summary of Recommendations

Challenge	Solution
Despite having some of the deepest and more mature capital markets worldwide, the UK has a large funding gap for SME lending and capital financing of green, infrastructure and other development projects. This funding gap is one of the reasons that UK workers are on average 30% less productive than competitors. Productivity has grown at an average rate of 0.3%[3]a year since the financial crisis. This is second lowest in the G7 and the worst productivity growth in Britain since the Industrial Revolution.[4]	• Establish a British Development Bank (BDB) to fill the gap left by commercial lending and mobilise up to £4 for every £1 BDB invests in infrastructure. • The BDB's design would take inspiration from the Green Investment Bank to utilise and leverage private capital to fund projects and businesses not supported by existing capital markets. By limiting activity to solving market failures, BDB would better avoid crowding out private investment, picking winners or competing with private banks. • Replace the annual £5.6 billion funding from the European Investment Bank (EIB) through capital funding for the British Development Bank.
The SME and infrastructure funding gap is particularly deep in the least prosperous regions, which typically offer lower margins and greater risk to commercial banks. Infrastructure spending per capita is over triple the rate in London as it is in the East Midlands and Yorkshire and the Humber. This compounds regional disparities. Partly as a result, GVA per hour worked in the UK is 35% below London and the South East.	• Provide a mandate to the new British Development Bank to specifically target investment in the regions, ranging from SME lending to capital investment in development projects. • Provide the British Development Bank with the power to issue regional bonds, ring-fencing funding for regional development in specific parts of the country that need it most.

The UK is now indebted at around three times the level of the long-run historical average, with further investment in the foundations of the economy needed to sustain a rapid recovery from the crisis. There is a premium on identifying productive investments that do not add to the national debt.	• The Government should allow the British Development Bank to issue its own national infrastructure bonds, supporting private financing of projects through loans and grants without adding to the national debt.

The challenge

This chapter sets out a number of fundamental problems in the UK economy as we went into the pandemic, which have led to our long-run productivity problems and prevented regional economies from growing as quickly as we might have hoped.

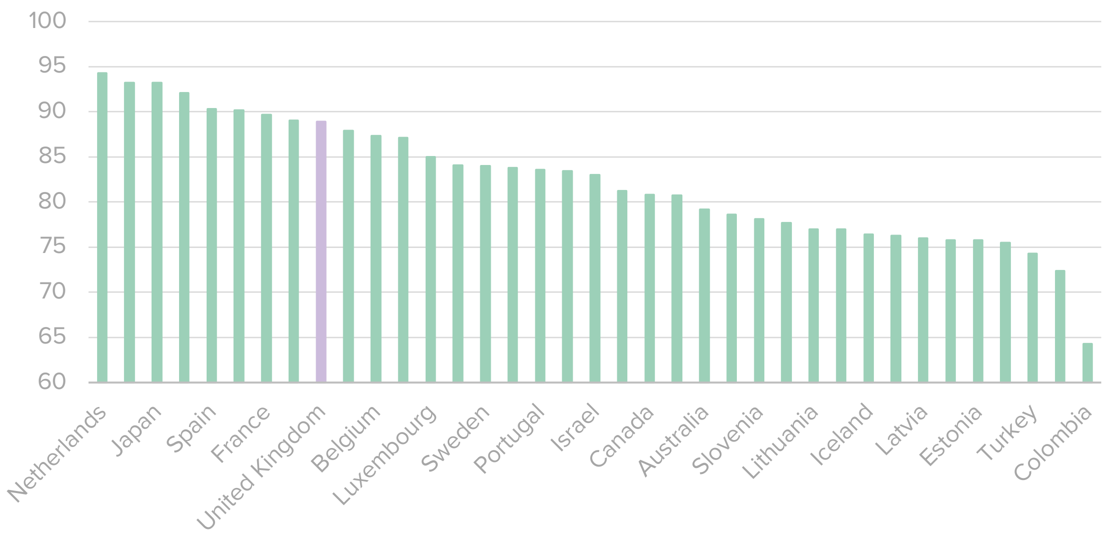
Alongside our weak skills base, the UK suffers from two core economic development weaknesses: weak infrastructure quality, exacerbated by an infrastructure funding gap, and an SME financing gap, which has worsened since the financial crisis. Both problems affect Britain's least prosperous regions the most. The next chapter sets out the case for a national development bank as the answer to these problems.

1. **The UK's competitiveness has long suffered from weak infrastructure**

- The current National Infrastructure Plan, covering 2016-21, describes infrastructure as "the foundation upon which our economy is built". In its work on Benchmarking Competitiveness, the National Infrastructure Commission has made clear the critical role of infrastructure in improving the UK's competitiveness, especially across three main parameters. First, improving access to markets, given infrastructure can make it cheaper and easier to trade both within the UK and with overseas markets. Second, improving access to mobile labour and capital, through support for inward migration and investment that moves people and capital to places where they are most productive. Finally, in agglomeration, providing the foundations for the emergence of globally significant economic clusters and assets.

- However, the UK has historically suffered from weak infrastructure despite our position as the sixth largest economy in the World. According to international rankings, the UK is ranked 11th in the world and 9th among the 27 countries of the OECD for overall infrastructure, which includes electricity, water, road, rail, aviation and shipping. The UK falls further on rankings for a number of specific types of infrastructure deemed essential to productivity. For example, the UK ranks 23rd globally for road infrastructure, and 17th in the OECD. For utilities, the UK ranks 21st in the world and 19th among developed nations.

Figure 1: Overall infrastructure rating, OECD countries.
Source: World Economic Forum's Global Competitiveness Index



- Experimental analysis from the Office for National Statistics last year examined the comparative stock of infrastructure between the UK and selected European countries. This analysis suggested that the UK has a relatively lower stock of infrastructure as a share of GDP (47%) than comparatively sized economies such as France (54%) and Italy (52%). Norway has almost double the level of infrastructure as the UK, at 90% of GDP in 2016, although this may be driven by the inclusion of high value oil rigs in the estimates.

- In recent years, the UK has started to redress this balance. As shown Figure X below, the UK has delivered higher levels of investment infrastructure compared to other countries over the last few decades. In 1997, the UK was 6th out of the 7 countries for which the ONS had available data. By 2016, the UK had risen to 5th out of the 8 which supplied comparative data. This compares to much smaller rises or no real change in most of the other countries considered. Meanwhile, UK infrastructure stock fare better when compared by population or geography. The ONS has found that infrastructure stocks per capita were fairly similar in the UK, France and Italy in 2016. In their study of eight comparison countries, the UK has the fifth highest infrastructure stock in relation to GDP but the second largest stock when comparing on a land-area basis.

Figure 2: UK infrastructure stocks lower than other EU G7 economies as a proportion of GDP.

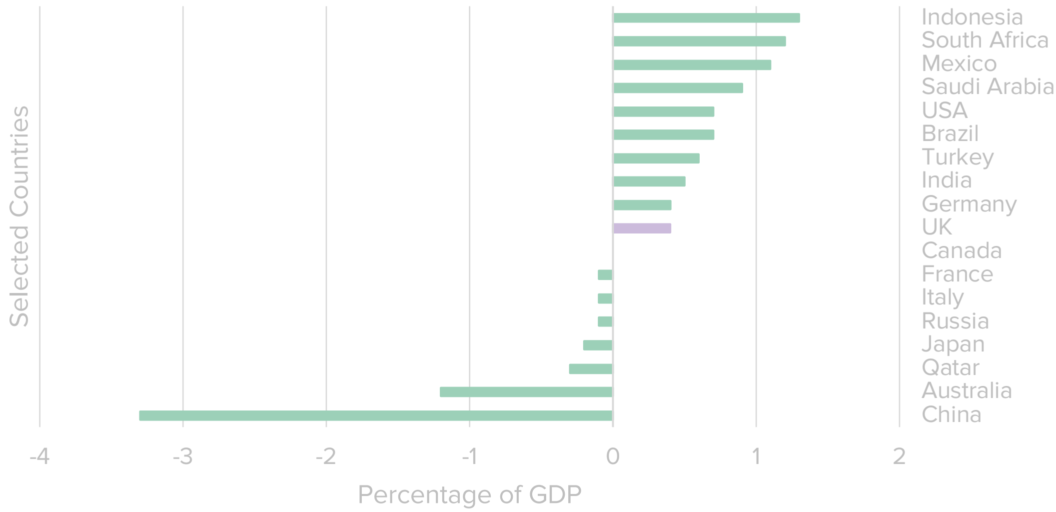
Source: ONS

2. The UK has a sizeable infrastructure funding gap

- The infrastructure funding gap is the gap between spending and estimated infrastructure needs. In the UK, McKinsey estimate the infrastructure gap to be 0.4% of GDP - or £8 billion a year - factoring in projected spending and estimated infrastructure needs up until 2030. This is similar to the 'global infrastructure gap' which is 0.4% of global GDP, or $5.2 trillion, but considerably lower than France, Italy and Japan.[5] Figure X illustrates this significant global infrastructure gap and the UK's place within it.

Figure 3: Gap between spending and estimated infrastructure needs (% of GDP)[6]

Source: Mckinsey



- The lack of investment and the resultant infrastructure gap costs the UK around £78 billion a year in lost output, according to the Civil Engineering Contractors Association.[7] This is predicted to rise to £90 billion by the year 2026. The same research finds that the UK GDP could have been 5% higher each year between 2000 and 2010 if our infrastructure had matched that of other leading global economies.[8]

- There is some evidence that the infrastructure gap holds back market confidence. In a recent CBI infrastructure survey, 94% of businesses said that the quality of infrastructure is a decisive factor when planning future investment and a majority of firms - 53% - are not confident they will see tangible improvement in UK infrastructure in the coming years.[9] This lack of market confidence reduces the UK's capacity for economic growth and productivity.

- The Government has attempted to plug this gap in recent years, with the launch of the National Infrastructure Commission and the National Infrastructure and Construction Pipeline published in 2016. This set out £500 billion of infrastructure spending - over 50% of which was to come from the private sector.[10]

- Even if these projects are delivered, it would mean that investment would average at 2.8% of national income each year. This would mean the UK would still lag behind the OECD recommended benchmark of 3.5% of GDP spent on infrastructure.[11]

3. This funding gap has been exacerbated by the sale of the Green Investment Bank and the departure from the European Investment Bank after 2020

- The Green Investment Bank was set up in 2012 to encourage private investment into the green economy. One of the key aims of the GIB was ‘additionality’, meaning that any investment given by the taxpayer was matched and superseded by the private sector input. An important indicator that tracks this is the “mobilisation rate”, which is the ratio of the volume of investment made by the private sector co-investors, to the volume of the GIB’s own project investments. A higher mobilisation rate means that the GIB investment encourages a greater contribution to the green economy from private sector capital for each £1 that the GIB invests. The average mobilisation rate for GIB’s investments was 3.4, showing the strong impact that the GIB had on green investment. [12]

- GIB successfully catalysed £15 billion of green infrastructure spending by 2015. However, to expand its operations it either needed to use government funds or borrow money. The first option would hurt the taxpayer. Some were concerned that GIB borrowing would increase the Government’s debt. As a result the Government decided that GIB would be better financed within the private sector, leading to the sale of the GIB to Macquarie Group in 2017 for £2.3 billion.

- The GIB invested in over 100 projects, with a total transaction value of £12 billion. It invested £3.4 billion of its own capital - thus enabling £8.6 billion of private capital investment. [13]Today, offshore wind powers the equivalent of 4.5 million homes annually and will generate over 10% of UK electricity by 2020.[14] Between 2012-2015, a majority of additional megawatts created by offshore wind were supported by either EIB, GIB or both.[15] Figure X visualises the impact that the GIB had on the industry.

- The European Investment Bank has played a similar role in the UK since we joined the European Union. The EIB was established in 1958 under the Treaty of Rome to finance further European integration, cohesion and growth. In 2000 the EIB Group was created with the EIB and the European Investment Fund as subsidiaries. Currently EIB Group has a balance sheet worth over €550 billion.[16] At its peak in 2015, the EIB invested £5.6 billion in UK projects, equivalent to approximately one third of infrastructure spending under the remit of the National Infrastructure Commission, and supported a range of regional development bank initiatives.[17]

- EIB itself focuses on investments throughout the EU and has been investing in the UK since 1973. In total the EIB has invested over €118 billion in the UK, financing over 1000 projects.[18] This has included major projects including crossrail and the channel tunnel. EIB investment peaked in 2015 at £5.6 billion, before being wound down rapidly after the Brexit referendum. This was equivalent to approximately one quarter of private infrastructure investment in 2015.[19] Without a replacement for EIB finance, the UK is likely to face a gap in infrastructure and SME funding.
- Under current terms set out in the Withdrawal Agreement, the UK will receive its share of the EIB's paid-in capital, totalling at just under €3.5 billion. This represents the UK's 16.1% share of the EIB's original paid-in subscribed capital. This capital has created €7.6 billion of profit for EIB, which is more than twice we initially paid in. This is not being returned to the UK, leaving a further financing gap in UK infrastructure.

Figure 4: Private infrastructure spending, EIB and GIB commitments[20]

Source: EIB, National Audit Office, ONS, Macrotrends [21]

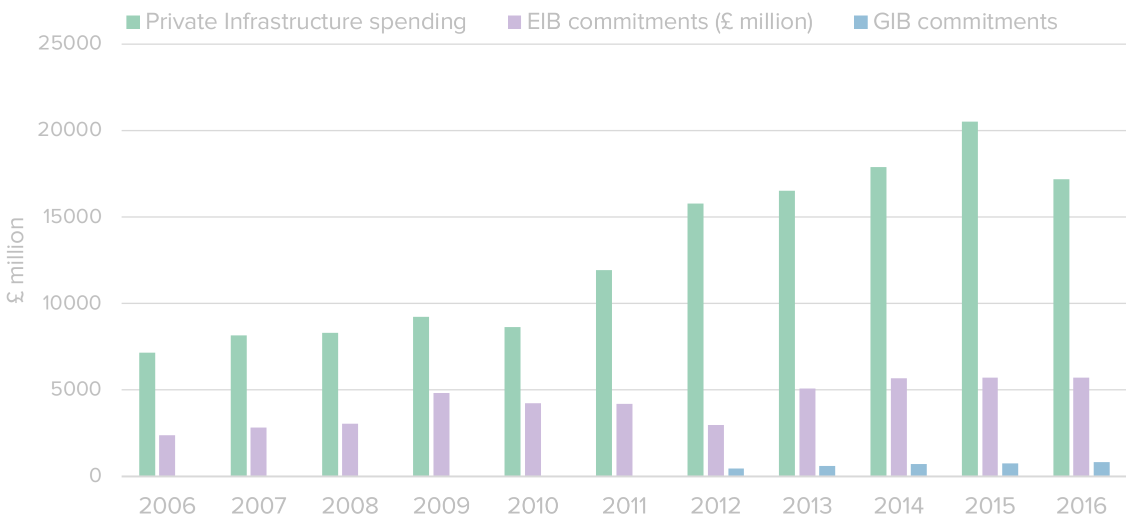


Figure 5: Annual investment in UK green infrastructure (£ billion)

Source: National Audit Office [22]

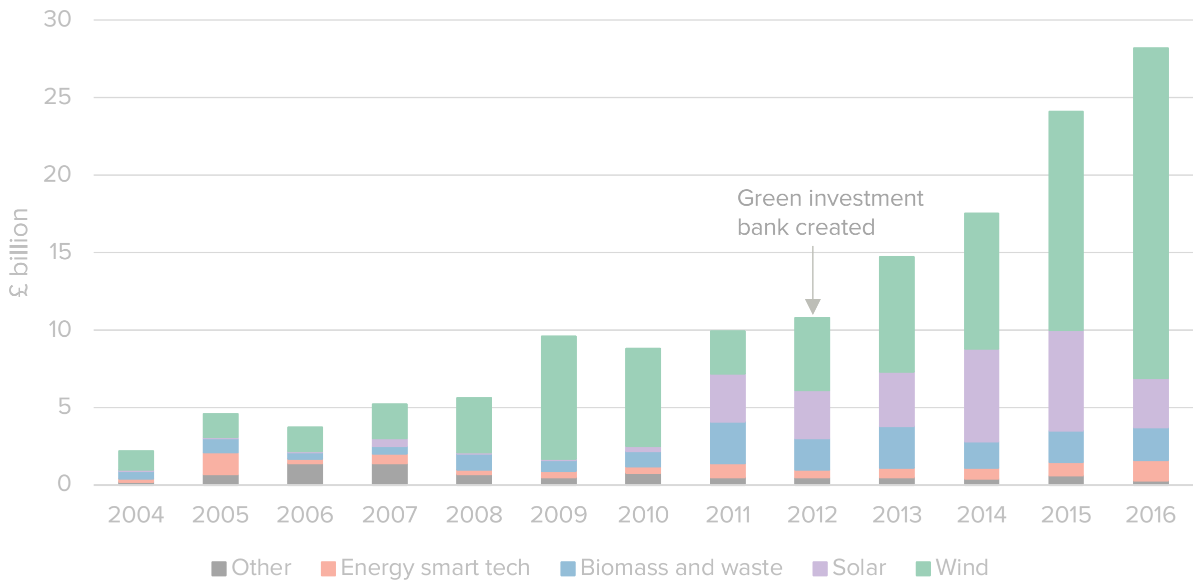
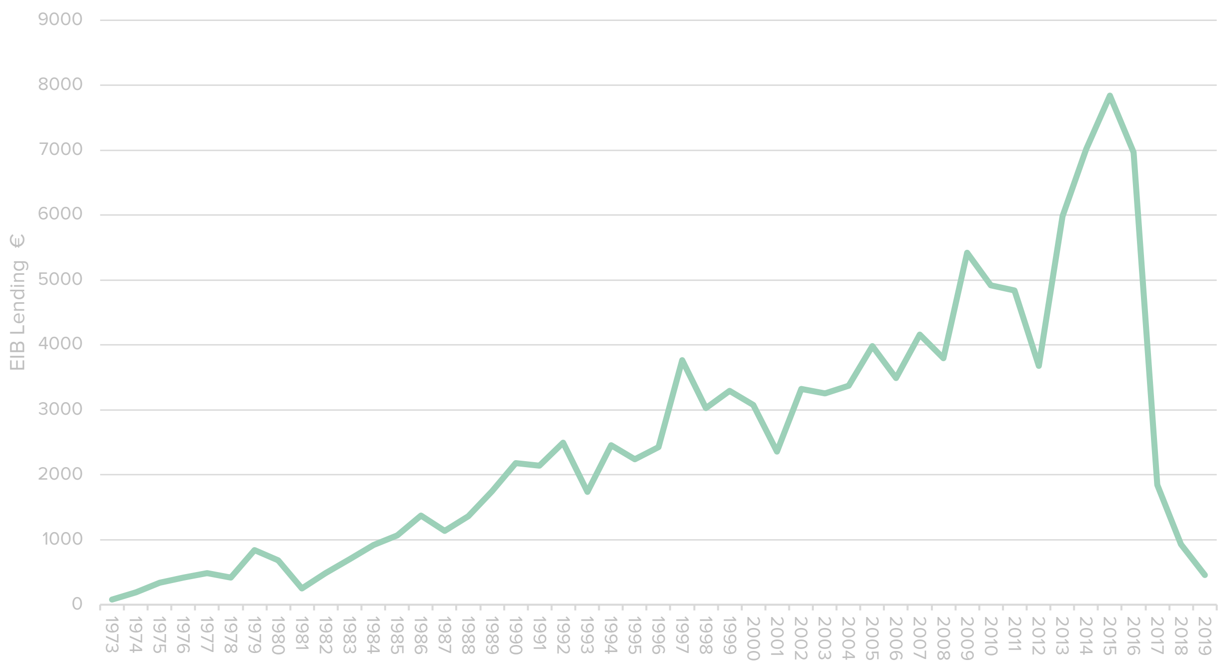


Figure 6: EIB investment into the UK (€ million)

Source: European Investment Bank [23]



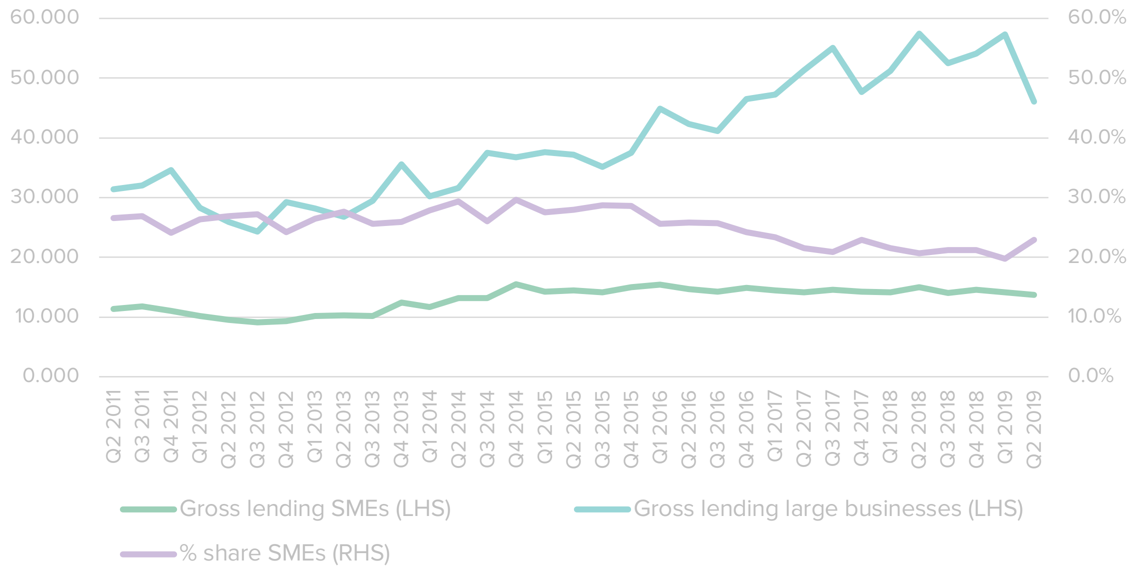
4. In addition, small and medium sized businesses have experienced a funding gap since 2008

- It took seven years for net bank lending to SMEs to return to its pre-financial crisis level. The effect of the 2008 recession was to spur banks to repair their balance sheets, which in turn led to a decline in higher risk, lower margin forms of lending such as small business loans. While this has been offset to some degree by the growth of alternative financing, such as peer-to-peer lending and crowdfunding, UK SMEs have nevertheless suffered an extended funding squeeze. In 2013, the National Audit Office identified a £22 billion SME funding gap.[24] Surveys suggest that almost three quarters of UK SMEs would prefer to grow more slowly than borrow to expand.[25]

- Before the pandemic, just 32% of UK SMEs made use of external financing, far below the 50% of SME firms that were not using external finance and had no inclination to do so. Of those who would like to borrow, surveys suggest that up to six in ten end up using personal funds instead. This has changed since March. However even after the introduction of the Coronavirus Business Interruption Loan Scheme (CBILS), there are only marginally more SMEs using external finance (41%) than permanent non-borrowers (39%).[26] While this may make such firms more resilient to shocks - recent Onward research suggests that over a fifth of UK firms could now be classed as “zombie” businesses - it indicates a financing shortfall for small firms.

The introduction of public development financing institutions, such as the British Business Bank and Northern Powerhouse Investment Fund, and the rise of alternative financing, such as peer to peer lending, has started to change this picture. The British Business Bank has issued a stock of £8 billion in financing support to UK SMEs to March 2020, with 98,000 business supported and considerable year on year growth in lending. The Northern Powerhouse Investment Fund controls £400 million of capital funding from the BBB, European Investment Fund, European Investment Bank and UK Government to support debt, equity and micro financing to firms and projects in the North of England. Peer to peer lending has grown from zero to 10% of all new financing for SMEs in the last eight years. All of the net growth in SME lending since 2017 has come from alternative finance. [27]

Figure 7: Gross lending flows to SMEs and large businesses, 2011-2018[28]



- SME financing options have grown at a considerably slower pace than the availability of financing for larger firms. Between 2015 and the end of 2018, gross flows of bank lending to SMEs fell as a share of total lending to private sector non-financial services firms from 28% to 21%. Meanwhile, bank lending to large businesses rose from 70% to 80%. Banks are typically more averse to lending to SMEs because they are heterogeneous and carry a higher level of risk and complexity.

5. These problems affect the Britain's lagging regions particularly badly

- Onward's work on regional growth has previously shown that there are no large countries in the G20 that are more regionally imbalanced than the UK and also richer than the UK per head. [29] Looking closer at the UK's development financing picture, we find that the problem is even more acute in different parts of the country.

- Infrastructure spending per capita is over triple the rate in London as it is in the East Midlands and Yorkshire and the Humber. London's infrastructure spending per capita is nearly double that of the UK average. Because of the way we fund infrastructure, there is a real risk that the distribution of investment serves to accelerate growth in places that already experience prosperity and leave other places to lag even further behind, levelling down rather than up. Since 2007, capital spending on transport has been around three times higher than in the East Midlands or South West and 2.75 times the average for the rest of England. This problem is even more acute when looking at the amount of spending per head for infrastructure. With this measurement, Londoners experience over quadruple the amount of spending per person than people from the East Midlands or the South West. Londoners also experience 2.5 times the spending as the national average of transport infrastructure spending per capita.

Figure 8: Regional Infrastructure Related Spending per capita [30]

Source: National Statistics, Country and Regional Analysis 2018; ONS; Onward analysis [31]

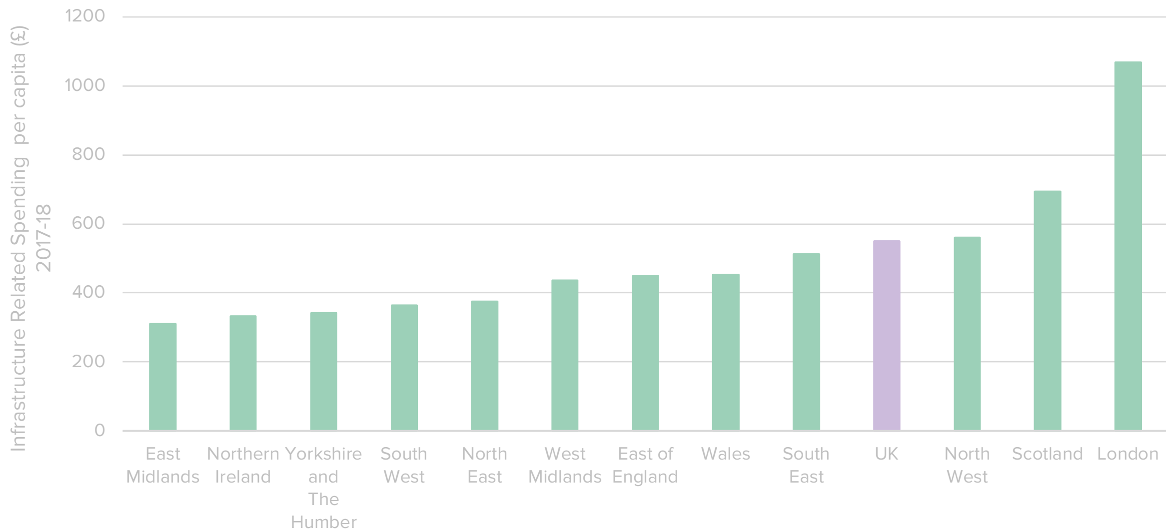
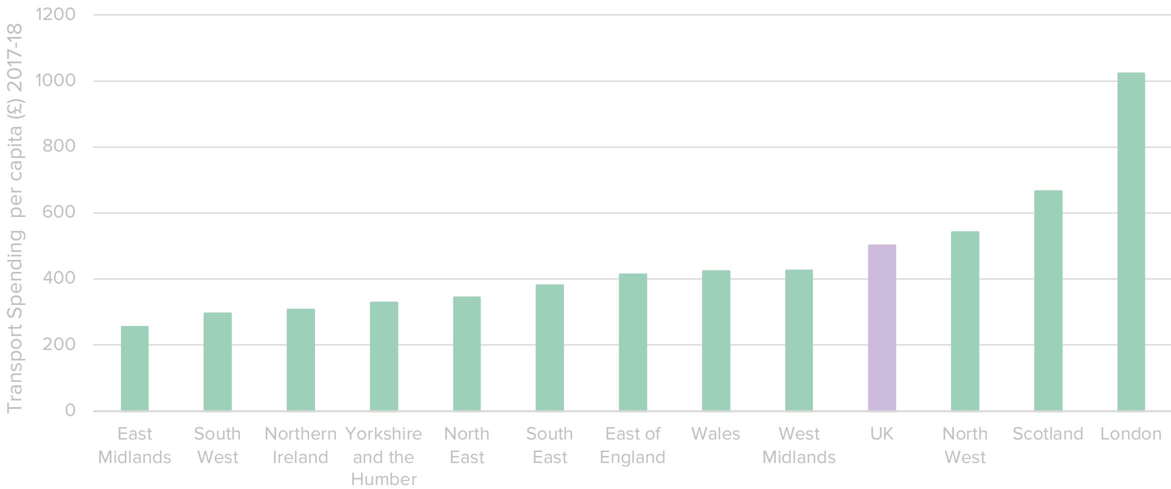


Figure 9: Regional Transport spending per capita

Source: Onward analysis, National Statistics, Country and Regional Analysis 2018. [32]



- The same picture is visible when considering SME financing. Bank of England lending data suggests that 25.1% of the flow gross lending to SMEs is to firms based in London, and a further 12.0% is to firms in the South East. This compares to 2.8% of lending going to SMEs in the North East and 3.5% of lending to Wales. Similarly, 21.2% of the stock of lending involves London based firms and 12.6% is based in the South East, against 3.2% and 4.5% in the regions with the lowest stocks of loans, the North East and Wales. Even taking into account the number of businesses in each region, we find that London receives a disproportionate share of lending, while the East of England receives proportionately the lowest levels of lending.

Table 1: SME lending by region
Source: UK Finance

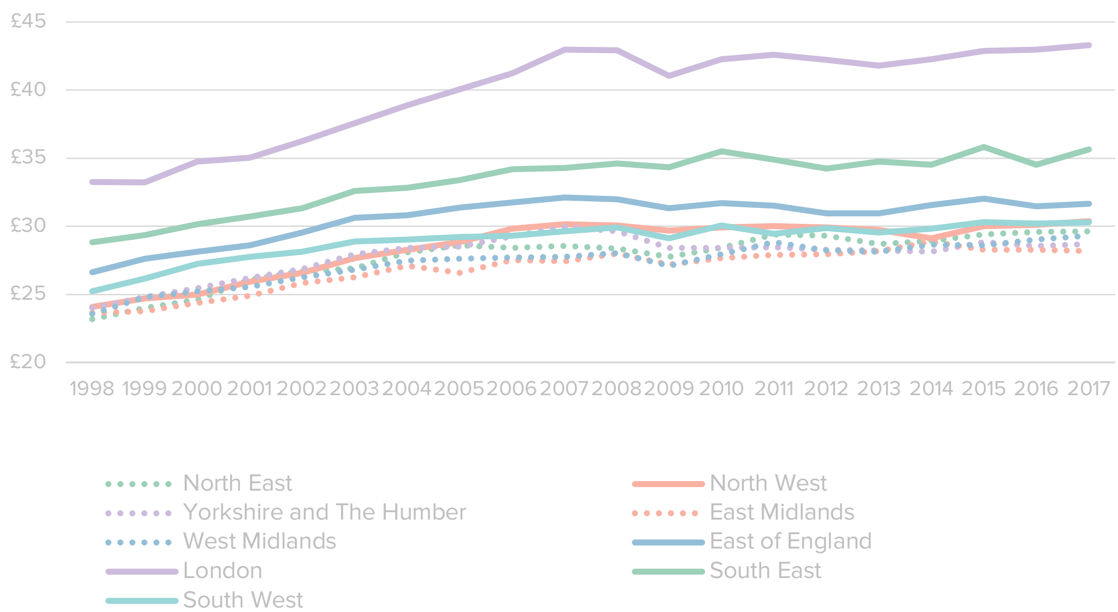
	Share of businesses	Share of gross lending
North East	2.6%	2.8%
North West	10.1%	9.9%
Yorkshire	7.5%	7.0%
East Midlands	6.2%	5.2%
West Midlands	8.3%	8.4%
East of England	10.4%	6.2%
London	19.0%	25.1%
South East	16.4%	12.0%
South West	9.8%	10.7%
Wales	3.9%	3.5%
Scotland	5.8%	9.2%

- The negative consequences of these trends are even more acute for these regions than for the rest of the UK. In terms of productivity, London has historically been ahead of the rest of the country, but the gap has widened and hardened over the last two decades, not least because of the disproportionate capital financing available in

London. As Figure X shows, Regional GVA per hour worked in London was 34% higher than the average for the rest of the country. This has soared since 1997 to 42% higher (£13) in 2017.

Figure 10: Regional GVA per hour worked by region, 1998-2018:

Source: Onward, Levelling Up; ONS Labour productivity tables



6. Yet there is no shortage of private investment in the UK seeking secure, long-run returns on investment.

- The UK's financing gaps are not down to a lack of available private sector capital. The UK is the second largest asset management centre of the world with over £7.7 trillion in assets under management [33] - £1.8 trillion of which is on behalf of foreign investors. Pension funds alone represent $120 trillion in global pension fund assets for example, and Legal and General have recently estimated that here in the UK there is £190 billion of domestic pension fund assets ready and waiting to be deployed to infrastructure.[34] These pension funds are already investing in securities and green bonds and could potentially invest in the UK too if bonds were available. [35]

- There is anecdotal evidence that pension fund managers and insurers want long-term secure investment, particularly in UK infrastructure. Legal & General Retirement Institutional chief executive Laura Mason noted in June 2020 that "by working with other insurers, we can use pension savings to help plug part of the UK's infrastructure gap, secure customers' pensions and encourage the economic recovery." [36] Nick Scullion, the head of the FP Foresight UK Infrastructure Income fund explains that investing in infrastructure can be a shock absorber for investors and "the infrastructure asset class offers investors meaningful diversification from traditional alternatives". [37]

- This is likely to grow given the likely persistence of an extremely low, and potentially negative interest rate environment, which constrains returns available to long-term institutional capital. Few disagree that the assets and potential private capital is out there, the issue is ensuring there are enough projects to invest in and that the securitisation to enable asset managers to invest is there.

7. Short termism and market inefficiency stifles investment

- There is a good argument that these problems amount to a form of market failure in UK financing of infrastructure project development and small businesses. A 2004 survey of members of the Investment Managers Association and the National Association of Pension Funds found that a third and two-thirds of members respectively believed their mandates for investment encouraged short-termism.[38] As Davies, Haldane, Nielsen and Pezzini remarked in their 2013 paper there is "a quantitatively significant degree of short-termism in capital markets, whether measured by the cost of capital or investment intentions". [39] This is particularly the case with the investment needed to kickstart new sectors or scale new technologies, such as green technologies, or to deepen existing sectors, where private capital is not willing to invest on its own due to lower initial returns or greater complexity.

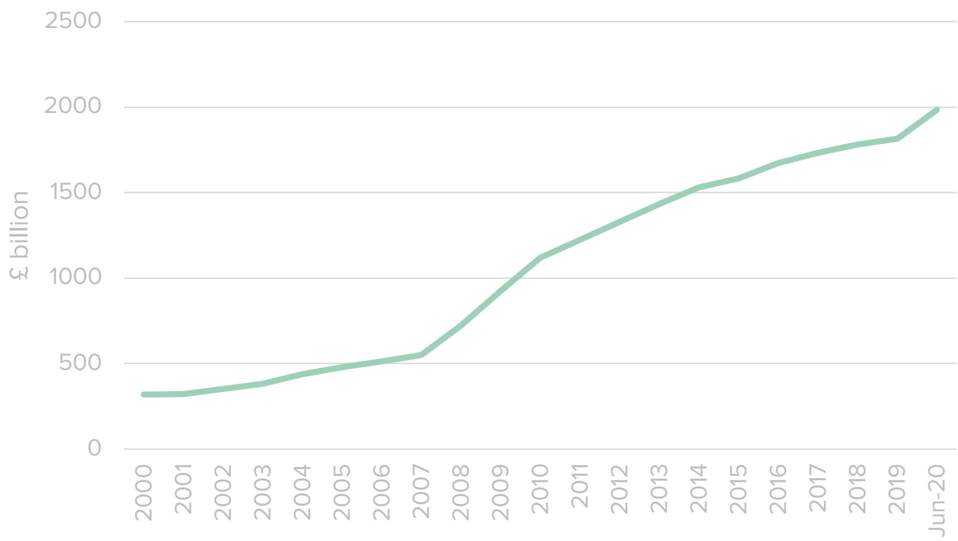
- This same short-termism has been seen in the past, as the LSE Growth Commission remarked in their 2015 report. In the 1930s the private sector's investment record was relatively poor, short termist and too fragmented to meet the needs of modern infrastructure. This, matched with the shift in economic thinking post-war, caused higher levels of state involvement in infrastructure funding. These new arrangements were successful in meeting the infrastructure needs that came with the economic boom after the Second World War.[40] In another report, The Growth Commission highlighted that an Infrastructure or Development Bank would be able to overcome these key market failures in capital markets. Reducing policy risk being a key benefit, as through partnership the finance can be structured so it mitigates and shares risk efficiently.[41]

8. An interrelated problem is the record government debt as a result of COVID-19.

- The problems with excessive national debt that are relevant to this paper are twofold. First, excessive debt levels constricts the Government's ability to borrow in order to plug the infrastructure funding gap. Second, excessive debt inhibits a country's ability to respond to crises. It is relatively easy to respond to a crisis when the national debt is small.

- The UK is now indebted at around three times the level of the long-run historical average. The public sector deficit is set to end the year at around 15%, up from under 3% after the Chancellor's March budget. This is significantly higher than the worst year of the financial crisis in 2008/09.[42] This is primarily as a result of necessary measures taken to support businesses and families during the coronavirus crisis. The Government is estimated to have to borrow over £400 billion over the next two years.[43] Already, the UK's debt to GDP ratio has leapt from 74% before the crisis to 100% and continuing to rise. This is a dramatic increase in a short time-span, but is just a continuation of the UK's historical trend of net debt since 2000, as Figure X shows.

Figure 11: UK Net Debt (excluding public sector banks)
Source: ONS



- This increasing debt burden comes at a time when there is a clear economic need to increase the levels of investment in the UK. Overseas, economic crises have in the past been helped by the use of development banks. In 2008, National Development Banks increased their lending from $1.16 trillion in 2007 to $1.58 trillion in 2009. This 36% increase was far greater than the growth in private bank credit in the same countries over that period, showing the counter-cyclical potential of development banks. [44] The Development Bank of Canada increased its borrowing by 10% to respond to the Great Recession.

- In response to COVID-19 a similarly strong response has been seen with the Islamic Development bank's $2.3bn [45] support package to tackle coronavirus.[46] The German Development Bank KfW, was also able to create the Special Programme and the Instant Loan, fully guaranteed by the government, and within weeks had extended existing programmes like the Entrepreneur Loan. More than €33 billion has been committed by KFW as part of its coronavirus response. [47] The next chapter will explore the different options for filling the infrastructure financing gap and the case for a UK development bank.

Solutions

This chapter explores the potential solutions to the UK's long standing infrastructure weaknesses, and in particular sets out the case for the establishment of a UK National Development Bank, to leverage much greater private sector financing, raise government-backed bonds and support greater regional investment.

The options available to policymakers

- If we accept there is a structural funding gap not provided by the market, there are ultimately three ways for the Government to help finance the UK's infrastructure projects and SMEs. First, they can increase direct public spending; second, they could enter into public private partnerships to share risk with private capital; third they could issue government guarantees to provide certainty to private finance and reduce the cost of capital. In the last twenty years, we have tried the first two. But, despite other countries' success, we have rarely used the last.

- Before the 1990s, infrastructure projects were designed, financed and operated by the public sector even if they were mainly built by private contractors. During this period, there was a long history of projects going wrong, budgets overrunning, assets produced were often of poor quality, and there was little incentive to maintain them properly. In 1999, a National Audit Office report found that only 30% of public procurement construction projects were delivered on time, and only 27% were within budget.

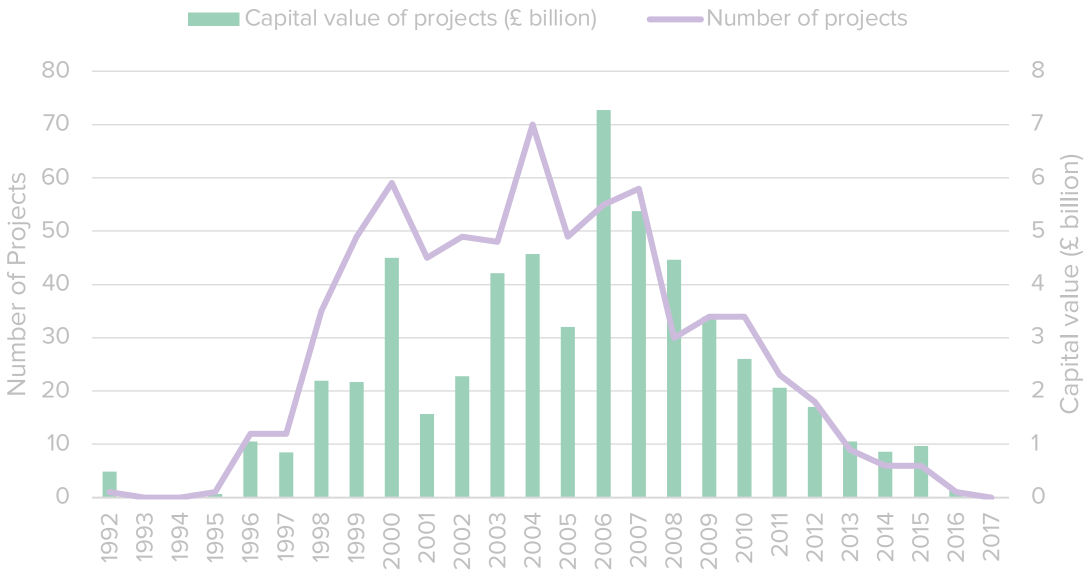
- A 2003 Treasury report outlined some of the issues with this approach of public procurement.[48] It showed a consistent pattern of new assets being delivered late and over budget, and where a project has faced difficulties the financial costs have been entirely borne by the taxpayer. For example, the London Underground Jubilee Line extension was delivered two years late and cost £1.4 billion more than original estimates. The Trident submarine shiplift and berth at Faslane rose from an estimate of £100m to a final cost of £314m.

- This led to other models of financing being explored. Few have gained such attention as the development of Public Private Partnerships and specifically Private Finance Initiatives that rapidly expanded in the 2000s. In the UK, the Government historically brought private investment into government-funded projects in sectors such as health, education, justice, defence and transport using Public Private Partnerships (PPPs). PPPs are long term contractual arrangements, usually for the construction and maintenance of an infrastructure asset over 25-30 years.

- Until 2012, the Private Finance Initiative (PFI) was the Government's preferred model of PPP. In 2012, PFI was replaced with Private Finance 2 (PF2), in response to widespread concerns about value for money. PF2 was used only six times, for projects with a total capital value of around £900 million, comprising only 0.5% public investment over the period 2012 to 2018. At Budget 2018, the Chancellor announced that the government would no longer use PF2 for new government projects, recognising that the model created a "fiscal illusion" and a long-term fiscal risk for the taxpayer, inflexibility for public service providers, and operational complexity for public sector contract holders. [49]

Figure 12: PFI projects by year (of financial close)

Source: HM Treasury [50]



- The final method for funding infrastructure is through the use of guarantees. This is when the government guarantees some or all of the interest payment on infrastructure debt bought by investors, thereby reducing risk which the private sector alone cannot bear. The UK has had the means to de-risk infrastructure projects since 2012, when the UK Guarantee Scheme was set up within the Infrastructure and Project Authority. At its inception, the UKGS was expected to issue up to £40 billion worth of guarantees funded by the Treasury.

- However, by 2017 the UKGS had only issued 9 guarantees totalling £1.8 billion, supporting £4 billion worth of investment.[51] This may be because the UKGS issues guarantees on a commercial basis, despite the point of a guarantee being to absorb risk the private sector is not willing to take. Given the GIB was able to commit £3.4 billion purely on green projects,[52] it is surprising that the UK Guarantee Scheme has only been able to commit £1.8 billion in nearly twice the time period.

- UKGS also has a weak mobilisation rate of 2.2 compared to GIB's 3.4 or EIB's mobilisation rate of 5. This suggests it is not being used effectively to find quality investments. The website listing UKGS projects has not been updated since 2017.[53] A more effective way to leverage government guarantees would be to establish a National Development Bank, as other countries have done. This is explored in the next section.

- The UK has its own historic experience in this space with Industrial and Commercial Finance Corporation(ICFC)/3i and the BBB, as well as the aforementioned GIB and EIB. The ICFC was formed in 1945 by the Bank of England and major British banks. Its aim was to plug the gap that smaller businesses faced in available corporate finance. Over the post-war era the ICFC became the largest provider of growth capital for unquoted companies in the UK. The ICFC was later renamed as 3i and made a public limited company. It was applauded by Donald Clarke, an ex director of 3i, as providing "a national service at no cost to the taxpayer and substantial return for its shareholders at minimal cost to them".[54]

- The British Business Bank was the Government's latest foray into this space, with a specific focus on supplying finance to SMEs. The BBB has been successful in its aims of increasing finance, seen by the £6.6 billion of finance supplied in the year ending March 2019, an increase of 27% on the previous year, supporting over 89,000 businesses. The BBB also has a focus on regional growth, with regional funds now supporting more than £240 million of finance. [55]

- But the level of support it is able to extend is still small compared to the potential demand from UK SMEs, and the level of finance available to UK firms is still small compared to financing available in other countries. In Germany, the public development bank is the second largest commercial bank in Germany, and represents around more than an eighth (12.7%) of total bank credit in the economy. If this is taken to include regional banks and other public development banks, the share of public banks in Germany represents about a quarter of total bank credit. In Brazil, BNDES represents more than a fifth of bank credit, 21%.[56]

The case for a British Development Bank

- National development banks offer an alternative way for governments to fill the infrastructure gap and counteract the pro-cyclical nature of private finance. From a theoretical perspective, NDBs can fill a number of known gaps in the financing of business growth and infrastructure projects. Namely they can provide financing that is (a) counter-cyclical, especially with regard to investment, (b) long term, especially with regard to supporting early stage or strategically important technologies or industries, (c) successful at mobilising wider resources, such as leverage from private actors, and (d) directed towards investment with positive social externalities but unpredictable market returns, such as infrastructure.

- While governments provide their paid-in capital, NDBs raise funds on the private markets, allowing taxpayer capital to leverage private finance. In previous crises, such as 2008, such banks, including the IMF, KfW and CDB, were able to counteract the downturn by sharply increasing lending at a time of weak private appetite. This can be particularly important during periods, such as that we are entering, when private lending is constrained by banks' weaker balance sheets and lower risk appetites. This funding uncertainty can prolong downturns and flatten the curve of recovery. In the first half of 2020, KfW more than doubled its lending commitments, including tripling the level of domestic promotion to £63 billion as a result of the coronavirus aid programmes.

- One recent analysis of National Development Banks in seven countries - China, Germany, Brazil, Mexico, Chile, Colombia, and Peru - shows that they can be highly successful at overcoming market failures, especially in new technology and infrastructure financing.[57]NDBs have funded new energy infrastructure, such as renewables and energy efficiency, as well as new technological progress in emerging industries. In Germany, the NDB, KfW, was initially the sole lender to private companies investing in solar energy.

- NDBs also have the potential advantage of not impacting the Government balance sheet. As they have their own balance sheets, including both assets and liabilities, they can be used to reduce the impact of infrastructure requirements on the national debt. Moreover, given they raise funds on the market through bonds they leverage large amounts of additional private capital to support such infrastructure, thereby reducing the direct taxpayer support needed.

- A further advantage of a bank structure - even for infrastructure funding where the state might be seen as having the lowest financing costs - is to act as a market discipline on infrastructure funding decisions and delivery. If investments have to produce real cash returns and persuade private investors to co-invest, the risk of politics-driven decision making leading to white elephants or other poor investments is reduced.

- The role of national development banks is best exemplified by the economic resurgence of Germany. The Second World War cut German GDP by more than 50% and the separation into East and West Germany left deep regional disparities. But in the last seventy years, Germany has delivered a remarkable turnaround - referred to by economists as the 'Wirtschaftswunder' or economic miracle.

- This miracle has been in no small part driven by the German National Development Bank, KfW, established in 1947 from funding from the Marshall Plan to support the post-war economic recovery. While proving causation is difficult, there is academic backing, for example a recent LSE report, that suggests the KfW was "one of the main promoters of the economic miracle in Germany". Unlike 3i, which was completely independent from Government and received no directions from either the Bank of England or the Government, KfW is owned 80% by the Federal Government and 20% by the regional governments. [58]

- The KfW's role has been particularly significant since the reunification of Germany in 1990. At the time of reunification, Germany had a regional inequality gap of almost three times higher than even the UK is today, as measured with the Theil index. KfW was instrumental in reducing the inequality gap, investing 185 billion euros in the new federal states of Germany, [59] with 70% of the bank's promotional activities being in east Germany in the early 1990s. Since 1991, almost one out of every ten euros invested in East Germany has come from KfW. [60]This helped reduce the gap in disposable incomes between East and West Germany by over 50%.[61] The success of Germany in levelling up between East and West Germany stands in stark contrast to the UK's growing regional divides since the 1990s, as set out below.

KfW in theory and in practice

The KfW refinances the majority of its lending capabilities in the international money and capital markets for the most part. It benefits from being guaranteed by the German Government and its accreditation amongst rating agencies: AAA at Fitch and Standard & Poor; Aaa at Moody's. This enables the KfW to issue bonds at the most favourable terms and as a result lend at the best terms. The main investors who buy these bonds are institutional investors, followed by retail investors. In 2019 its refinancing volume reached €76.2 billion.

These funds from the financial markets are then added to by budget funds from the Government if an activity requires additional subsidy. For example something with a higher risk, like innovation and start up finance.[62] KfW has €506 billion in commitments, making it one of the largest development banks in the world.

It has been impactful in infrastructure development in a number of areas, most notably in the green transformation. It is estimated to have funded at least one third of total funding of green infrastructure, in some years this was even higher. In 2012 KfW funded $11.4 billion of renewable investment, which is over 50% of total renewable investment, including 90% of onshore wind.

Figure 13: Regional Inequality measured with the Theil Index

Source: Onward's calculations; Roses and Wolf database on regional GDP[63]

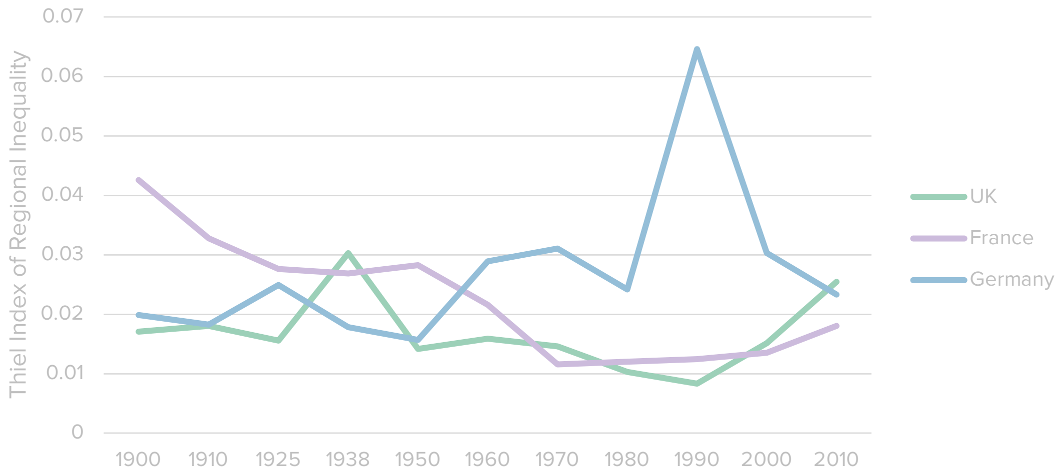


Figure 14: Real GDP per Capita, UK and Germany.

Source: University of Groningen, Maddison Project Database 2018

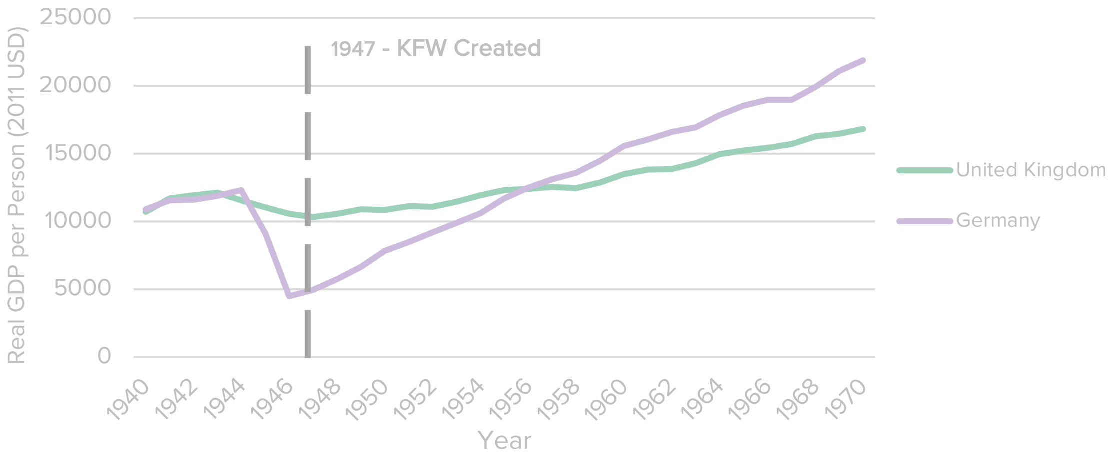


Table 3: Case studies of National development banks

	Development Bank of Japan	Canada Infrastructure Bank	Kreditanstalt für Wiederaufbau (KfW)
Background	The Bank was established in 2008, replacing its previous incarnation. This move was undertaken to prepare the DBJ for privatisation and signalled a gear change away from “community development, environmental conservation and sustainable societies” and towards “high-value-adding” investment to appeal to future shareholders. Plans to privatise the bank have since been shelved.	The Bank was established in 2017 with a mission to work with provincial, territorial, municipal, federal, indigenous and private sector investors to change the way that infrastructure is planned, funded and delivered in Canada. Provides low-cost financing and support to projects where there is a clear lack of capital.	The Bank was established in 1947 to assist in the reconstruction of Germany after the Second World War. Over time, KfW’s mission has expanded to include overseas development cooperation, corporate project finance, loans for individuals and SMEs and a focus on sustainability and climate.
Assets and levels of activity	The bank holds the equivalent of £123 billion in assets. Historically funding has been sourced. They are mandated to use their capabilities to help respond to crises such as the Great Japanese Earthquake in 2011.	CAD $35 billion Has a mandate to invest in projects which are "in the public interest" but may not be invested in from the market on their own.	€506 billion in commitments
Credit Rating	Moody’s - A1 S&P - A+	N/A - The bank is financed through Government funding.	Moody’s - Aa2 S&P - AA+
Funding sources	The Bank now raises capital from the market, although the majority of capital is guaranteed by the Government	Funded directly by the federal Government.	Raises majority of funds from capital markets
Governance	Government run organisation. It’s top three executives are picked by the Japanese Prime Minister.[64]	Crown Corporation, fully accountable to the Government.[65]	Government-owned but operationally independent. Board drawn from public and private sectors and is chaired by Government ministers. [66]

Recommendation one: Establish a British Development Bank

We recommend that the Government should create a British Development Bank (BDB) which would be owned by the British Government, under the oversight of HM Treasury. The purpose of the British Development Bank would be to unleash a wave of infrastructure project financing and small business lending, and it would have powers to sell bonds and oversee state owned financial institutions.

Its operations would have three primary stages - raising funds from private investors; using loans and other financial products to invest in infrastructure and mobilise additional private investment; and boosting infrastructure levels to improve regional growth and increase GDP.

The Government could establish the British Development Bank with a small amount of one-off seed funding. We suggest £2 billion of seed funding, primarily for illustrative purposes. This money could be almost completely offset from the £1.8 billion UK Guarantee Scheme, which has proved inefficient compared to development banks and is due to end in 2026.

The majority of British Development Bank's funding would come from loans to the private sector. This would be similar to KfW, which receives 99% of new funding from capital markets. The British Development Bank, in consultation with the Treasury, would issue the bonds. We expect this to be cheap since real bond yields are negative for state-owned organisations. Critically, this also will not contribute to the Government's debt. We discuss the details of borrowing and why it would not be on the Government's balance sheet later in this chapter.

To fund infrastructure and SMEs, development banks typically use loans, guarantees and equity, but other existing financial products may be used. In using loans, the British Development Bank would lend to private and public sector organisations. When selling a guarantee to investors, BDB would guarantee a return for investors if the project failed to go ahead. With equity investments, BDB pays for a share of the return of the project, funding the project and sharing the risk. With the financial returns to these investments, BDB would accumulate wealth, allowing it to continually fund investments.

These tools do not just directly fund projects, they further mobilise private capital to invest in the same projects and businesses. Development and infrastructure banks mainly mobilise private investment in two ways: signalling and reducing risk. Infrastructure projects face substantial construction risk, particularly if there are potential planning problems. Guarantees and equity investments reduce the risk of projects to investors, mobilising additional private capital into the projects. The same is true in the SME space, where development funding can improve the appetite of commercial banks.

Like other development banks, BDB would need to be well respected for having expertise and build a track record of delivery. So if BDB invested in a project, private investors would follow with the confidence that the project is a good investment. In a study on the UK's Green Investment Bank, an investor was asked for his perspective. He said "banking is about perception and perceived comfort with risks and if the Green Investment Bank has said that it's good then it's good. It is a huge deal".[67] Thus the British Development Bank does not just invest, it mobilises private capital too. As the then European Investment Bank director said in 2012, "[the EIB is an] investment enabler not [an] investment funder".[68] This ability of development banks to mobilise private capital is known as 'crowding in'.

Crowding in or out?

A common critique of development banks is that they do not increase investment but instead crowd out private investors. By taking the low hanging fruit of investment, development banks might encourage private investors to take their wealth out of infrastructure.

This paper argues that with the right planning the British Development Bank would have 'additionality', meaning it can provide more investment in infrastructure than the private sector can do alone. In other words it can crowd in more than it crowds out.

The Green Investment Bank was at the forefront of ensuring additionality and shows us how BDB should limit crowding out. It would only offer financial support if the project tried and failed to get finance from the private sector first.[69] Although this does not guarantee that GIB supported projects would not have eventually found finance from the private sector, it does lower the chance of this.

The GIB extensively used innovative de-risking strategies to ensure it would build socially useful infrastructure the free market failed to provide. Building offshore wind farms involved substantial risk due to technological and logistical challenges of working in a marine environment. GIB funded offshore wind projects by buying equity in them.[70] This moved the risk onto GIB, allowing private investors to then fund the rest of the projects with loans. Once construction was complete and the risk gone, GIB would sell this equity back to the private sector, ensuring it did not crowd out the role of the private sector. This allowed GIB to keep reinvesting and focus on de-risking new projects rather than playing a role private banks could perform.

Research from UCL economist Mariana Mazzucato supports the idea that state infrastructure investment crowds in, not out.[71] In studying 17 countries over 11 years, Mazzucato and co-authors found that public investment in low-carbon energy infrastructure consistently and always caused additional private funds to be invested in the same area thereafter.

To judge the effectiveness of the British Development Bank we must estimate how much private capital is brought in. The ratio of total infrastructure investment created to that solely put in by a development bank is called the mobilisation rate. As previously mentioned, GIB is estimated to have a mobilisation rate of 3.4. For every £1 it spent, £3.4 of investment was created.[72] The European Commission claims that once money is actually in a fund or development bank, its investments have a mobilisation rate of 5.[73] A mobilisation rate of 4 would be reasonable for a British Development Bank, given the mobilisation rates of the GIB, 3.4, and the EIB, 5. This means the £4 billion in the British Development Bank could immediately create £16 billion worth of investment, £12 billion of which does not come from BDB itself.

This activity could have a significant impact on GDP growth. As a meta-analysis on the effects of infrastructure investment in OECD countries shows, for every 10% increase in the public sector capital stock, GDP increases by 1.2%.[74] Unfortunately the public sector capital stock is only a measure of government owned infrastructure. For ease we assume this is the effect of all infrastructure private or public.

Using IMF figures[75] for the public sector capital stock and World Bank figures for GDP[76], this implies that £16 billion of new infrastructure spending is equivalent to a 1.3% of the public sector capital stock, implying a long run 0.2% increase in GDP, increasing the country's output by £4 billion. These estimates all come before BDB has reinvested its profits, at that point the true effects may be many times higher. Furthermore, the effect of ‘core infrastructure’ has twice the effect size on GDP than just the public sector capital stock so our estimates are especially conservative.[77] On the other hand, we do not know how much of this investment is additional, so we ignore the effects of crowding out which biases our estimate upwards.

Although the calculations are crude, that £2 billion in Government seed funding could create £16 billion of infrastructure investment is striking, especially after ignoring the potential for reinvestment.

Green Infrastructure

Development banks can support projects supporting renewable and nuclear energy which do not just create benefits in terms of higher productivity and jobs, but they also solve market failures by reducing externalities from pollution. Firms that emit carbon do not fully internalise the cost they are doing to the environment and the rest of the planet, meaning that they produce too much pollution. By using loans and guarantees to subsidise green energy, the UK’s emissions will fall to a more efficient level.

Development banks have a strong record in performing this function of green finance. As discussed Britain’s Green Investment Bank was pivotal to causing 10% of our energy needs to come from wind power. However Britain’s GIB was just one of 15 green investment banks globally in 2015. [78] The evidence suggests these banks performed well economically, had high mobilisation rates and reduced emissions. Upon GIB’s project maturity they were expected to create a 9% return. From 2012-19 Australia’s CEFC has returned $712 AUD million to pay debt or the taxpayer from its $7.2 billion of commitments.[79] This investment is estimated to have prevented 260 million CO2 equivalent emissions. Like GIB’s mobilisation rate of 3.4, CEFC has a mobilisation rate above 3.

Whilst green infrastructure is important having a general purpose British Development Bank would allow the Government to support both green and ‘brown’ infrastructure as is necessary. KFW shows that a conventional development can take a green focus seriously as 38% of their lending is for environmental causes. Thus creating a British Development Bank could also help build a green recovery.

Recommendation two: The Government should consolidate existing financing institutions into the British Development Bank

Over time, the Government should consolidate the Commonwealth Development Corporation (CDC) and the British Business Bank (BBB) within the newly created British Development Bank (BDB). This could be easily done by the Government transferring its equity in BBB and CDC to the British Development Bank. A successful precedent for this umbrella structure is KfW in Germany. Like our proposed British Development Bank, KfW has the three components: supporting SMEs, overseas development and infrastructure investment. KfW has AAA ratings from independent agencies and receives 99% of its funding from capital markets. It is able to borrow at low yields because it is exempt from corporation tax and its debt obligations are explicitly guaranteed by the federal government. The benefits of this for the UK would be threefold.

1. The ability to issue bonds to self finance

The CDC, BBB and the former GIB are in fact funds, rather than banks, as they do not have the ability to raise additional finance. [80] By consolidating the BBB and CDC into one British Development Bank, the new entity would be able to issue its own bonds and fund new operations. With approximately £7.5 billion[81] of assets from the CDC and BBB, a new development bank would win the confidence of investors in order to pursue new programmes such as investing in green energy, public infrastructure or buying equity from SMEs struggling with the pandemic. [82]

By issuing bonds for all components of BDB they would have a higher liquidity than if the BBB or CDC issued bonds alone. This ensures the UK's state owned development institutions get the cheapest funds possible. For the Treasury to easily oversee bond issuance ensuring best practice, it would also be easiest to have an umbrella organisation, such as a British Development Bank, through which development financing can be held accountable. Private correspondence with the British Business Bank confirms that the Treasury would prefer one institution to be able to issue bonds, rather than multiple.

Coronavirus is likely to increase the Government deficit to over £337 billion, leaving little room for funding government financial institutions. Yet with gilts reaching a negative nominal yield and over £9 trillion of assets controlled by fund managers [83] there is a significant amount of private capital to be raised for public good. KfW bond yields are approximately 30 basis points higher than German federal bonds. This is because they have less liquidity, meaning there are fewer of them and they are traded less. This makes it slightly harder to sell huge amounts of them in a rush. It is likely that BDB bond yields would be 30 basis points higher[84], but it could be less.

If the British Development Bank's bond yield were only 30 basis points higher, the Government would be able to borrow at a real interest rate of about -2.8% on 5 year bonds, making its funding exceptionally cheap. By contrast, private sector infrastructure bonds have a premium of 100 basis points over Government bonds.[85] This ensures BDB can invest in projects the private sector cannot afford to, allowing BDB to solve market failures. With this financial cushion, BDB need not be purely driven by the profit motive, allowing it to issue socially beneficial guarantees or loans the private sector is unable or unwilling to make.

A British Development Bank, after initial seed funding from the Government would then be financed by its own bond issuance and not from the taxpayer. A House of Lords EU committee report suggested that the debt of such a development bank would be on the government's balance sheet. [86] This is not necessarily the case.

2. The Government could take infrastructure debt off the balance sheet

Currently the public sector net debt includes any debt owned by a public sector organisation. However, in many countries the definition is different. For example, KfW's debt is not considered German government debt.[87] KFW borrows money to invest, ensuring its assets pay its debts. This means taxpayers do not need to pay for KFW nor would they have to pay for a BDB. Only if a development bank defaulted would the taxpayer have to pay the bill. However, the only development bank that has ever defaulted is the Land and Agricultural Development Bank of South Africa, resulting in a $200 million bailout. Since taxpayers are extremely unlikely to pay for BDB debt it would be misleading to put its debt on the balance sheet.

The definition of public sector net debt is defined in the public sector finances bulletin produced by the Treasury and ONS.[88] The Chancellor would only need to bring our statistics in line with Germany's to ensure British Development Bank debt was off the balance sheet and not distorting it. If every EU country used the same accounting rules as Britain by including all debt of public sector organisations, then Germany would have the second highest gross debt to GDP ratio in the EU because of the debt of its state owned banks.[89] Given the extraordinary high levels of investor confidence in the German Government, it is clear that incorporating development bank debt onto the balance sheet would be misleading.

Taking British Development Bank's debt off the balance sheet would not be without precedent. After the financial crisis of 2008 many private sector banks, including RBS, were bailed out by the Government. This technically makes RBS a public sector bank. However, the ONS and Treasury changed public sector net debt to delineate public sector net debt excluding public sector banks. ONS justifies this move by saying that the Government does not need to fund RBS's debt and that surpluses achieved by RBS would not be passed to the Government.[90] The exact same arguments would apply to British Development Bank. BDB's debt would be financed by its profits and no surpluses would go to the Government since all profits would be reinvested.

3. Economies of scope and scale means operational costs are reduced and accountability increased

Eva Witt, a senior vice president within KfW, noted that by running an umbrella of services including SME lending and export finance, KfW only needed one set of accountants, one department for compliance and one HR department. [91] There are other plausible economies of scope. For example, staff and expertise could be shared across areas of work. The BDB, by working across different areas can be a one stop shop for firms who want financial help. A firm that comes to BDB might also be introduced to available other services, allowing each component of the BDB to attract clients to other components. This would be especially true if BDB were to expand into export finance or green finance. By offering a wider scope of services, consolidation would reduce the cost of each one individually.

At the same time, a large base of assets from BBB and CDC, alongside seed capital, would mean the British Development Bank would be a safer bet for investors. This would lower the bank's borrowing costs allowing it to provide more services and expand its services in beneficial directions. Despite its debt induced expansion, the British Development Bank would only need so many managers or board members allowing it to do more with much of the same resources.

Consolidation would also improve governance. There are over ten state run development finance institutions in the UK, making it complex and difficult to hold institutions to account. In the long run BDB could consolidate many institutions, including UK Export Finance or even the Public Works Loan Board or Big Society Capital. If the CDC and BBB were consolidated, one annual report and contact with one director would report on their activities. This increased oversight would negate the chance of duplication and increase efficiency of operations. It would also ensure that there is a narrower focus for targeted scrutiny by Select Committees and Ministers. Bringing a number of state owned financial institutions at once would be difficult to manage quickly. We therefore propose that such a transition takes place over a number of years, after which the British Development Bank would be a single umbrella organisation.

Recommendation three: The British national development bank should be given an explicit regional mandate

To create a strong one nation out of our United Kingdom, all the regions must share in prosperity and growth. By rectifying the lack of investment in the regions, a British Development Bank can level up the whole country fairly and unite the country. This could be achieved in a number of discrete ways.

First, the Government should enshrine reducing regional disparities in the National Development Banks constitution. This would follow the approach taken by KFW which was given a mandate of 'Aufbau Ost' - 'Reconstruction of the East' - after the fall of the Berlin Wall.[92] The same principle can be replicated for the newly formed BDB. The mandate should specify that the bank should be focused on 'infrastructure for the regions', in particular those with lowest productivity and the lowest levels of growth over the last three decades.

Second, the Government should bake in regional growth by providing equity in the British Development Bank to the devolved administrations and give Mayor's, Local Enterprise Partnerships (LEPs) and Combined Authorities a direct opportunity to consult with BDB's leadership allowing for scrutiny.

By sharing ownership of the British Development Bank across the central and devolved government, the whole of the UK can have a say in our economic development. Holding shares in BDB could give the four nations voting powers over the BDB's priorities, and ensure they are consulted if any changes occur. The regions of England without their own devolved government should nonetheless be consulted through standing scrutiny and engagement with Mayors, LEPs and combined authorities.

Ensuring a Development Bank is not entirely owned by the central government is not a new idea. 80% of KfW is owned by the federal government, whilst 20% is owned by regional governments. Similarly, many nations have stakes in multilateral development banks such as the European Investment Bank, the World Bank and the Asian Infrastructure Investment Bank.

Third, the BDB should create regional development bonds and ringfence bond revenue for reducing regional inequality. In a similar vein to the national war bond programme, which the Government launched to raise more money to finance the ongoing cost of the First World War, these regional development bonds would be available to ordinary citizens so that they can invest in infrastructure outside of London and the South East.

Such a bond would act as a loan to the British Development Bank over a set period of time, the money from which, unlike normal government gilts, would be specifically ringfenced to tackle regional inequality. In return, bond holders would be paid interest as well as getting their full loan amount back at the end of the period. It would also provide an opportunity to give more people a real stake in our economy. With 62% of 25 to 34-year-olds not able to own a home, and only 12% of UK stocks owned by individual citizens, regional development bonds available to everyone would help both fund regional development and give people a stake in it.

ESG Bonds

Regional bonds are only one example of Environmental, Social and Governance (ESG) bonds that BDB could issue. Many other ESG bonds have been tried and tested by development banks to raise capital for projects. For example, the African Development Bank issued $3 billion of social bonds for the purpose of fighting coronavirus, making it the largest dollar denominated issuance of a social bond. National development banks including Spain's ICO, Italy's CDP and Germany's KFW issue 'social', 'sustainable' and green bonds.

Crucially, to issue these bonds, banks create frameworks that define what these bonds may be used for and how to report the management and use of proceeds. For example, Italy's CDP has a framework that ensures their green, social and sustainable development bonds may only be used to exclusively fund UN sustainable development goals. This helps provide confidence to investors and the public that private capital is being raised for public good. Bonds without robust frameworks may provide funds to non-ethical goals, taking advantage of the goodwill of investors or creating a false ethical image to the public. . Thus whether BDB was trying to create a green recovery or sustainable development, ESG bonds with a robust framework would ensure it remained disciplined and effective in its mission.

Endnotes

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[2] Gramlich (2019), 'East Germany has narrowed economic gap with West Germany since fall of communism, but still lags'.

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[5] The global gap for 2016–30 as a share of GDP is calculated by adding negative values, converting to dollar terms, then dividing by cumulative world GDP. Without adjusting for positive gap, the value is 0.2 percent. This has been calculated from a set of 49 countries for which data are available for all sectors. This gap does not include additional investment needed to meet the UN Sustainable Development

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[12] NERA, UK Green Investment Bank (2015) – 'Examining the Case for Continued Intervention'

[13] National Audit Office (2017), 'The Green Investment Bank'.

[14] RenewableUK.

[15] ibid.

[16] EIB, Key Figures.

[17] NIC (2017), Congestion Capacity, Carbon.

[18] EIB, United Kingdom.

[19] Around half of the volume of new EIB commitments are to SMEs (25bn support for SMEs in 2019 but 58bn of new projects made in 2019). However EIB investments in the UK are nearly all infrastructure related.

[20] NB. Estimates of private infrastructure investment are experimental statistics from the ONS. Not all EIB or GIB commitments may come under the same definition of private infrastructure investment. This means we cannot be certain what proportion of private sector investment came directly from the development banks. The graph is of EIB/GIB commitments as a % of private infrastructure investment is only meant to show off the scale of the role development banks have played in the UK's infrastructure investment.

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Elected as the MP for Grantham and Stamford in December 2019, Gareth previously served as a senior director of a $500bn global investment company, working with some of the largest pension and sovereign wealth funds in the world in the United States, Europe, China and the wider Asia Pacific. He formerly held the positions of Head of North America, Global Head of Strategic Relations and Global Head of Responsible Investment Business.

He has served on a national government taskforce for HM Treasury and the Cabinet Office. In 2014, Gareth helped establish a £150m fund that invests in UK infrastructure, universities, charities and housing authorities. In 2018, Gareth was named one of European finance's top 'rising stars' by Financial News. He holds degrees from the University of Nottingham and the John F. Kennedy School of Government, Harvard University. In 2020, Gareth was appointed to the House of Commons Finance Select Committee and serves as Vice Chairman of the All-Party Parliamentary Group (APPG) on Sustainable Finance and the All-Party Parliamentary Group (APPG) on Financial Markets and Services.

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