Grantham Research Institute on Climate Change and the Environment

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A strategy for restoring confidence and economic growth through green investment and innovation

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<u>**Headline issue**</u>

With fiscal policy generally constrained by the need to restore confidence in the sustainability of public debt and the effectiveness of monetary policy to stimulate growth is reaching its limits, the question arises: what can advanced economy policymakers do to restore economic growth and stimulate investment? A powerful instrument to restore growth is clear and credible policy to encourage investment in welfare-enhancing activities that need public support to be commercially viable. The low-carbon and wider 'green' sector is an exemplar for this.

<u>**Key points**</u>

- Periods of economic slowdown are the best time for governments to support investment due to low resource costs and low potential to crowd out alternative investment.

- There is no shortage of private capital available for investment. In fact, private agents are squirrelling away record saving into 'risk-free' assets earning zero and sometimes even negative real interest. As a result savings are losing value by the day - a truly perverse state of affairs given the need for productive investment.

- Economies are trapped in a classic 'paradox of thrift', in which greater saving and cost-cutting is the rational response to economic gloom at the level of an individual business (which also sheds labour), bank (which restricts credit) and household. But when everyone retrenches simultaneously, fear of extended recession becomes a self-fulfilling prophecy.

- Governments are currently limited in their ability to offset private saving by extra borrowing, but they do still have the power to restore confidence in publicly driven markets by using carefully chosen instruments to stimulate private investment.

- Policies to encourage low-carbon investment offer broad opportunities to restore confidence and to leverage additional, rather than displaced, investment. Credible green policies can reduce risk for businesses to the point where green investment is seen as a better means of restoring net worth than sheltering saving in 'risk-free' assets that earn zero real interest.

- The private sector is not heavily investing in green innovation and infrastructure because of a lack of confidence in future returns. Confidence can be restored if governments incentivise investment by taking on elements of this policy risk. By backing their own low-carbon policies, governments can stimulate additional net private sector investment, and thereby make a significant contribution to economic growth, employment and public debt reduction.

For more information about the policy brief, please contact Chris Duffy, the Policy Communications Manager at the Grantham Research Institute. Phone: 020 7107 5442, Email: c.j.duffy@lse.ac.uk

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