Conflicting duty for government? The UK's new Green Investment Bank

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On Wednesday this week the UK's Secretary of Department for Business, Innovation and Skills, Vince Cable, officially launched the UK Green Investment Bank, a quasi-public lending institution with a mandate to invest 3 billion pounds of tax payer money in clean energy and other infrastructure projects that have an environmental protection element.

There are many things to like about an institution that invests in projects for the public good as cautiously as a private bank might, but that should not distract tax payers in the UK or elsewhere from the considerable potential downsides of this hybrid model.

One risk is that a portfolio of long term investments held by the government will tie the hands of the government's own policymakers from adapting policy over time to accord with changing public preferences. The government will need to make energy and environment policy in line with its long term interest as an investor of public money. It will also need to make policy in line with the evolving needs of the public which it is supposed to serve and represent. A conflict of duties arises when it must do both. The UK Green Investment Bank and public-private investment institutions similar to it are more likely to succeed if one is frank about this conflict.

The UK Green Investment Bank was set up largely to boost capital investment in the UK's aging energy infrastructure. Energy companies were not willing to invest in the kinds of clean energy projects the government wanted for the future of the energy system. The energy companies felt that government's policy framework was not 'long, loud and legal' enough for clean energy investments to be viable. A main reason for setting up a Green Investment Bank and capitalising it with 3 billion pounds of public money was to signal to private investors that government is committed to clean energy in the long term, and to leverage this commitment to pull more private investment into the sector.

The new, conflicting duty for government is rooted in the fact that many of the Green Investment Bank's investments will depend on the deep and elaborate system of subsidies, tariffs, standards and taxes that the government has put in place to meet its environment and energy goals. Without these penalties and enticements, many of the Bank's investments would amount to much more questionable uses of public money. It will typically take many years for these investments to realise a reasonable rate of return. During that time, a lot will happen that will put pressure on government to adapt its energy and environment policies. Energy prices will rise and fall. Governments will come and go. New technology will emerge. What is concluded from the science about what should be done to protect the environment will change.

Government policymakers tend to be doing a good job when they adapt policy to respond to these changes and the changing public needs and preferences these changes engender. Government policymakers tend to be doing a poor job when they stop responding to the changing needs of the stakeholders it is supposed to serve.

As the sole initial shareholder in the Green Investment Bank the government will now need to make sure that policy stays stable enough over the long term for the investments it has made to pay off. If it does not, tax payer-funded investments underperform. At the same time it needs to continue to do the job it has always done of listening, aggregating and responding to the changing preferences of its constituents in the short term in order to remain legitimate to them. If it does not, the quality of this most basic function of government has suffered.

One way out of this conflict would be for the Green Investment Bank to invest – somewhat paradoxically to the reason for setting up the Bank -- in projects with shorter term time horizons. This would reduce the pressure that would otherwise build up between government capital's need for long term policy stability and government policymakers' duty to respond to short term changes in public preferences through policymaking. Another solution would be for the Board to invest in projects that have an environmental protection element but which do not depend on the tangle of subsidies, taxes and tariffs that can and should change over time. Industrial energy efficiency is one example.

David Grover
Grantham Research Institute on Climate Change and the Environment
London School of Economics and Political Science
Houghton Street
London WC2A 2AE
United Kingdom

d.grover@lse.ac.uk
(+44) 0789 969 1268
http://personal.lse.ac.uk/grover/