

Negative interest rates are an opportunity for the UK to invest in sustainable infrastructure

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The new UK Government under Prime Minister Theresa May has [committed to boosting UK productivity and addressing the widening wealth gap](#). Achieving all this will require the right investments by both the public and private sectors at a time of heightened economic uncertainty.

The UK Government could improve economic growth by taking advantage of negative real interest rates to borrow money to invest in sustainable infrastructure and innovation for energy, transport and cities, as I point out in [two new reports](#). Such a programme could [boost economic growth](#) without inflation, increase financial returns to private sector investors — including household pensions, reduce the risks of destabilising [price ‘bubbles’](#) developing in the housing market and elsewhere and help to secure the stability of public finances. It would also help to bridge any shortfall in investment that might arise from the referendum vote to leave the European Union.

[Weak productivity growth](#) has meant that even though UK unemployment has remained low since the financial crash, [real wages have fallen](#). Attempts by the Bank of England to [inject liquidity into the economy](#) and offset the Government’s fiscal austerity have widened the wealth gap between rich and poor. Investors’ ‘search for yield’ in a low-interest-rate environment has pushed up asset prices in bonds, equities and especially housing towards record levels. While those hardest hit by fiscal austerity are the poorest in society who rely directly on public expenditure, the beneficiaries of rising asset prices from easy money are disproportionately those at the top of the income ladder.

A common feature underlying these factors is a shortfall in UK investment and a [surplus in global desired net saving](#). Unlikely as it may seem, this environment of [negative real interest rates](#) provides an opportunity for the Government, but it is [unlikely to last forever](#). The UK Government risks missing an open opportunity to boost economic growth by investing public funds in productive infrastructure.

Some in the Government worry that ‘unsustainable’ borrowing might deter investors, but the collapse in UK

Government bond yields tells us that the markets are signalling for more, and not less, public investment, with little concern for the risk of debt default or inflation. The deterioration in the public finances reflects the automatic response to low private spending since the financial crash. To the extent that UK private spending has picked up, the data shows that it is mostly driven by household consumption while [firms continue to hold back on spending for investment](#).

UK investment, the key underlying driver of per-capita growth in the economy, has entered a [prolonged slump](#) despite the unprecedented persistence of near-zero real interest rates. At the same time, substantial household borrowing has required funding from abroad. As a result, the UK current account deficit widened to 7.3 per cent of GDP in the fourth quarter of 2015, the largest quarterly deficit since records began in 1955.

There is strong evidence to suggest that returns generated on well-managed, carefully selected public investment projects are significantly higher than their financing costs. By boosting economic growth, this offers the Government the opportunity to capture the returns and service its debt through a mix of direct charges and levies and higher general tax revenues.

The [Organisation for Economic Cooperation and Development \(OECD\)](#) suggests that an annual investment of 3.5 per cent of GDP into infrastructure is necessary in developed countries to prevent growth being undermined. According to HM Treasury, the UK spent an average £47 billion a year on infrastructure (public and private) between 2010-11 and 2013-14, around 2.75 per cent of annual GDP. The UK regularly scores poorly on international comparisons of its infrastructure. In its [Global Competitiveness Report 2015-16](#), the World Economic Forum ranked the UK to be 24th out of 144 countries for the overall quality of its infrastructure, behind most of our main competitors.

The economic arguments show convincingly that money is available for investment in sustainable infrastructure in the UK. Moreover, infrastructure investments will last 20 years or more and so must be designed to avoid [locking in to, stranding and possibly scrapping](#), carbon-intensive assets, networks and behaviours. Any government investment in large infrastructure needs to be 'fit for the future' and allow the UK to [stay competitive](#) by shifting resources to [fast-growing](#) and [innovative low-carbon markets](#). However, careful institutional design is required to enable this investment and limit political short-termism. There are five main areas in which action should be taken:

Reforming Whitehall

- The creation of a new Department for Business, Energy and Industrial Strategy (BEIS) provides an opportunity to bring energy and climate policies into a more coherent framework of industrial strategy. However, HM Treasury often determines public expenditure at a great level of detail and [has the ability to shift policy significantly](#).
- Reforming the design of institutional frameworks is required to promote stable policies that are free from short-term political interference by devolving responsibility for complex decisions to independent technocrats who operate transparently and are accountable to Parliament.
- Develop fiscal rules in line with the principles of full resource-based balance sheet accounting, which distinguish between borrowing to invest and borrowing to consume.
- Prioritise investments with a positive financial return to the public finances over more expensive [off-balance-sheet investments](#).

Effecting Devolution

- [Devolve decision-making](#) and financing to the local level, providing increased fiscal autonomy for cities and reforming planning laws, and [freeing-up institutional capacity](#) in Whitehall.
- Build upon existing city governance mechanisms and planning systems to enhance civic autonomy.

Enabling the National Infrastructure Commission (NIC)

- Give the Government the ability to issue infrastructure bonds through the NIC.
- Provide risk guarantees and define a long-term vision of coherent policies to keep the infrastructure project pipeline full.
- Commission an independent assessment to consider bringing Private Finance Initiative (PFI) contracts on-balance sheet and devolving responsibility to the NIC to carry out a rigorous business case assessment for investments that are believed capable of generating positive returns.

Natural capital accounting

- Adopt the recommendation from the [Natural Capital Committee](#) that the NIC should have a natural capital investment plan.
- Ensure the NIC encourages infrastructure investment in capital assets that are compatible with ambitious decarbonisation.

Empowering the Green Investment Bank (GIB)

- Capitalise the GIB and provide risk guarantees to reassure private investors that the Government's reduced minority share in the GIB constitutes a sufficiently large stake to mitigate against sudden and adverse policy changes.
- Consider the NIC taking on all GIB infrastructure-related projects.

Tapping a global reservoir of free capital would help the government to boost the UK's productive capacity, re-balance the economy and secure a smart, efficient, low-carbon future. Targeted infrastructure investment would also boost the value and resilience of public assets, reflecting the fact that not all public borrowing is equal; it is necessary to distinguish between borrowing for productive purposes and borrowing for current expenditure. Boosting investment and taking the [pressure off the Bank of England](#), which is [running out of monetary ammunition](#), would also offer private investors, in particular pension, insurance and sovereign wealth funds, a much sought-after reliable source of long-term income.

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Notes:

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