



HOUSE OF LORDS

Select Committee on the European Union

Financial Affairs Sub-Committee

Oral evidence: Brexit: the European Investment Bank

Wednesday 12 September 2018

10.15 am

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Members present: Baroness Falkner of Margravine (The Chairman); Lord Butler of Brockwell; Lord Cavendish of Furness; Lord De Mauley; Lord Desai; Lord Giddens; The Earl of Lindsay; Baroness Neville-Rolfe; Lord Thomas of Cwmgiedd; Lord Vaux of Harrowden.

Evidence Session No. 1

Heard in Public

Questions 1 – 19

Witnesses

I: Phil Graham, Chief Executive, National Infrastructure Commission (NIC); James Richardson, Chief Economist, National Infrastructure Commission (NIC).

Examination of witnesses

Phil Graham and James Richardson.

Q1 The Chairman: Good morning, Mr Phil Graham, Chief Executive of the National Infrastructure Commission, and Mr James Richardson, Chief Economist at the National Infrastructure Commission. You are very welcome to our brief inquiry on Brexit and the European Investment Bank. I need to do some formal housekeeping, so let me go through that. You have before you a declaration of members' interests. This is a public evidence session and it is being broadcast live on parliamentlive.tv. A full transcript is being taken and will be made available to you shortly after the session.

I will kick off by dwelling a little on your National Infrastructure Assessment, which was published earlier this year. What were your main findings regarding the state of the UK's infrastructure? I note you go quite far down the road, until around 2050. What were your key recommendations to the Government in that regard, Mr Graham?

Phil Graham: The National Infrastructure Assessment is one of the three key parts of our remit. We look at individual infrastructure challenges at the request of the Chancellor. We hold the Government to account for delivering our recommendations. At the heart of this sits the broad, overarching assessment, which, as you say, takes a 30-year look and looks crucially at infrastructure in a cross-sectoral fashion. We are required to look at energy, transport, water, communications, waste and flood defences, but crucially to look at the interactions between them and think about how our infrastructure operates as a system.

It is important to state, particularly in the context of this discussion, that the work that we did was focused predominantly on long-term infrastructure need, and so setting priorities for investment and policymakers over the longer term. The key recommendations that we made were around the need to move swiftly to deliver a full fibre network for the UK and to incentivise competition within the digital market to deliver that. They were around a strong case for increasing the use of renewables within our energy sector, and we set a target of reaching 50% renewables in terms of power generation by 2030. Alongside that, we suggested some caution in the scale of any nuclear programme over that period.

We made recommendations about the decarbonisation of domestic heat, and about continued funding and a continued focus on energy efficiency in our homes as a way of moving towards a decarbonised energy sector. We made recommendations on electric vehicles, on funding and devolution to enable more effective urban transport, on setting higher standards of resilience and long-term targets for leakage reduction in the water sector, and on a national standard for flood resilience.

Alongside those sectoral recommendations, we also looked at some of the key thematic issues that would make it more or less challenging to deliver the infrastructure that the country needs over the long term. Crucial within that is the question of funding and financing, because that is clearly a key issue in the nation's ability to meet those needs.

The first part of that work looked at what the Treasury slightly clunkily calls our fiscal and economic remits. The fiscal remit in particular sets a hard guideline budget for long-term infrastructure spending, so we looked at whether and how the recommendations we made could be made affordable within that remit. The economic remit is the requirement on us, for those infrastructure sectors that are privately financed, to be transparent about our expectation of the impact of our recommendations on consumers' bills.

In order to get the most out of those two remits and in order to deliver the most with minimum impact on consumers within the envelope that we been provided in terms of public investment, we looked at some of the specific financing challenges. We looked at the potential for PPPs to play a continuing role, and particularly we looked at the risks around the status of the UK's relationship with the European Investment Bank.

That piece of work was the one that led us to the conclusion that retaining access to the EIB should be the priority, and, if that cannot be achieved, it is time now to start thinking about a plan B, and that there could be a role for a UK investment institution of some kind in filling some of the gap—not necessarily everything but some of the gap—that is currently filled by the EIB.

Q2 The Chairman: We are going to pick up some of the issues that arise from that analysis. We have had a look at chapter 7 of your report on funding and financing. I had a question on that particular issue. It seemed to me, reading the tables in there, that you faced this challenge of, certainly in the next 10 to 15 years, those large infrastructure projects pushing up against the envelope. There is not very much left over. The question that came to mind was about the fact that, as we understand from other interlocutors, EIB lending has reduced or is already reducing in the United Kingdom. We cannot put a finger on why that is happening. If the committed expenditures are already there and absorbing so much of the envelope, in the nearer term—the next decade or so, which is when the impact of Brexit will be felt most tangibly—how do you see that shortfall, or that ability to have some leeway and flexibility, being filled?

Phil Graham: It is important to say you are right that the current programme of planned investment—and that includes some that is firmly planned and some that is clearly intended but not necessarily committed to—takes up a large chunk of the fiscal remit envelope, as it is put. In the very early part of the 2020s, it pretty much wipes it out, but as you move beyond 2022 or 2023 some headroom starts to build up.

It is important to recognise within that that if the Government do follow through on their guidance to us and turn that 1.2% envelope into an

actual budget for infrastructure expenditure, that is in itself going to equate to a significant increase in the levels of infrastructure funding that we have seen over the past decade or so. Before jumping to a conclusion about a further significant increase, there is a question about the capacity of the system to build up to that. What we hope to some degree is that the stability that the NIC strategy should provide, if the Government accept it, gives the industry space to respond and make that happen.

There are some challenges around the edge of that. It may be, for example, in terms of urban transport, which is one of the areas where we suggested the most significant increase in funding over the long term, and actually in terms of the larger transformational projects, that those are probably going to take 10 years or so to deliver. There may be smaller schemes that can be taken forward more quickly if the funding can be identified.

In many cases there, the challenge is less the financing question, which is the one that the EIB is best placed to solve; it is the funding question and the certainty that the revenue streams will be there to repay the finance. In many ways, the certainty, if the Government follow through on this, that the fiscal remit and longer-term guideline budget provides might help square that circle and be able to bring in sources of private finance and so on. That has been an important part of our consideration of the response to any loss of EIB funding. This is not the only source of finance for infrastructure projects in the UK, and in many cases you would want to be sure that anything that is publicly generated is not unhelpfully crowding out investment.

James Richardson: The only thing I would add is that obviously most of the EIB finance that comes into the UK goes to private sector infrastructure. That spending is obviously not affected by the fiscal remit, which is public spending. In that sense, the question is predominantly one of whether private infrastructure companies in the UK can find alternative sources of finance if the EIB is not available. In many cases, they will be able to do so; they may have to pay a little more. The issues that we are concerned about are those areas where particularly you are bringing forward new technologies, and where actually it may be rather harder to find private finance. That would be the thing that we are most worried would get lost here.

The Chairman: I notice that housing is not covered. The EIB was quite active in supporting housing associations. Where do you think that gap will be filled?

James Richardson: It is outside of our remit, so we have not looked at that.

Q3 **Lord Desai:** We could do this sort of work through the general budget of financing, or we could set up an independent institution. Is the advantage of having an independent institution just that the debt does not appear on the government books? Now that there is the argument about whether we impose too strong constraints about government borrowing now that

interest rates are low, could we not switch back to general public finance lending?

James Richardson: Actually, if you set up a UK institution, it almost certainly would score within public sector net debt, although not in some of the other fiscal aggregates. It is certainly true that if you finance it through the EIB, it does not show up, but if you financed it through a UK institution, then actually the presence of the institution would not affect the balance sheet treatment. There are advantages of having an independent institution rather than, as it were, operating it out of the Treasury or the Infrastructure and Projects Authority.

I would point particularly to two things. One is independence. It is important in terms of the ability of the institution to put a stamp of authority on a project that private investors can then have confidence in that this is an independent institution making financially sound judgments. There is a risk, if all these decisions are being signed off by Ministers, that private investors might think, to put it at its most extreme, "Is it Concorde?" Is it something that Ministers think is exciting but actually is not a sound investment? You then lose that stamp of approval and the potential benefit that has in terms of bringing other people on board.

The other thing that you get with an independent institution is it is probably easier to attract expertise. Inevitably, it is hard to pay civil servants in the Treasury or wherever the kinds of salaries you would for really top people in financial services. It is a little easier, if you create an independent institution, to get around some of those constraints that you probably need to get around if you are hiring people to run a major financial institution with a large balance sheet.

Lord Desai: Is it because they are better at risk-taking?

James Richardson: It is an interesting question. They may be, as it were, more balanced in their risk-taking if you have a financially savvy board. I am not sure that an institution would necessarily take more or less risk than something in government, but it might take better risks in that it may be less likely to pursue things that are politically attractive but bad financial risks. Equally, it may be more willing to take a little more risk on things that actually are good financial risks but politically less attractive.

Phil Graham: It is not impossible for government, but it becomes easier in risk terms for an institution of this kind to manage its risk as a portfolio, which is to some degree one of the advantages you get, rather than these investments simply being sucked into the entirety of the government finances. There are some advantages of that kind.

Lord Desai: We know who to blame when things go wrong.

James Richardson: You can set an institution a very clear lending remit; it is clear what it is supposed to be there for and what it is not. That then allows you to set a portfolio within that remit very clearly.

Again, you have parallels with something like the Bank of England, where the politicians set the remit but the Bank makes those decisions. There is an argument about whether it is better or not, but I think most people think it probably is.

The Chairman: Without wanting to put words in your mouth, do you think there is also a benefit of countercyclicity in the sense that if you think immediately after the financial crash, having an independent institution like the EIB there to inject funds was actually quite helpful, whereas government would not have been in a position to do that at that point in time?

James Richardson: It helps to have institutions in place when you get these unexpected events, because you have the capacity that you need to act quickly. The Bank of England is a good example. The Bank of England did not really use its balance sheet particularly aggressively until the financial crisis, but you had an institution that had the capability to do that and was therefore able to step in and come up with interventions, like the FLS or whatever. The Treasury has some of those capabilities and showed that in the financial crisis in terms of its ability to act. You would have more depth and capability if you had a freestanding institution that would put you in a better position if you were hit by a shock.

Q4 **Lord Cavendish of Furness:** There has been some talk in the press about the use of project bonds; it has been discussed a little in Parliament, and the Government have even mentioned it—the Victorian way of financing. Could it have legs? It is used elsewhere.

James Richardson: I am not specifically aware of discussions within the UK Government. The real question would be, if we are talking about public financing here, what the benefit of a specific project bond is over general government borrowing. It may be, if you can tap particular pools of investors who are particularly interested in those kinds of bonds, that you can get a better yield than you can on general government debt. Of course, that is quite a hard thing to do because you suffer from the lack of liquidity compared with the gilt market.

The other question is whether there is perhaps a sharper discipline on the project management if you have issued specific debt for that project. It is interesting, for example, that Transport for London chose to issue its own bonds for the Northern Line extension rather than go to the Public Works Loan Board. That was partly about the discipline in having a specific debt on that project. There are advantages to it, but you have to weigh those against the fact that probably you are paying a higher cost of finance than simply financing through gilts.

Phil Graham: You are right in the sense that if you do lose EIB funding, we have to think what about the spectrum of interventions is, and which are the right interventions in which case. For something like Thames Tideway, the government intervention has not been to provide the finance directly; the government intervention has been to take on a certain amount of risk that has allowed the project to be financed not

quite at government rates but at a lower rate than it would have been otherwise.

Lord Cavendish of Furness: I read again and again that there is masses of money sloshing around on balance sheets. What is the way of releasing it?

James Richardson: Our general view is that the challenge is not in general financing. If a project is bankable, it is financeable. It is these areas where, particularly for new technologies, the private investors may be warier of investing in something that does not have a track record and where there is a big cost in being the first institution to do due diligence and see that this is a viable investment. Of course, once you have done that, all of your competitors can partly share in the fact that you have done that. Of course, they will do their own due diligence, but they kind of know that they are letting themselves in for something that somebody else has put a stamp on, and so nobody wants to move first. A publicly backed institution can say, "We will move first", and then leverage in finance from other people who then have that assurance. That is the issue rather than the aggregate availability of finance.

Q5 The Chairman: Just to pick up a tiny point there, I had always thought that first-mover advantage is most palpable in the kind of technologies that you are talking about, where there is an issue that is digital, rather than old, traditional technologies. Is that not the case?

James Richardson: First-mover advantage is more likely to be for the provider, as it were, than for the financial institution that is backing it. There is also a life cycle with these technologies in terms of the degree of certainty in the investment and the degree of risk. Often, the first mover actually does not necessarily win out, because they take a lot of the risk and a lot of the cost of developing it, and then somebody else may come along and win out, so it is not necessarily true. You want to be early, but you do not necessarily want to be first.

Phil Graham: Where the areas are that you are actually talking about genuine technological risk deserves thinking about. In digital, in terms of rollout of full fibre, it is not really a technological risk. People know how full fibre works; we can dig up the road and stick it in there. The risk is in how the market is going to respond to that. The area where this type of approach has been most obviously valuable from the work that we did in the past was in offshore wind, where it does not feel like new technology—it is sticking a load of concrete in the sea and building a tower on top of it—but whether you can make that work, make the system flexibility and whether that will stand up to the environmental conditions was quite seriously challenging and uncertain.

The Chairman: It is a very good point at which to talk about the environment and bring Lord Giddens in.

Q6 Lord Giddens: I was pleased that environmental issues loomed large in your opening statement. I would like to ask you briefly three quick

questions about the Green Investment Bank. How important was that bank in supporting environmental investment? What would be the consequences of its privatisation? Should any aspects of what that bank did be incorporated into a new UK infrastructure system or programme, and how would that be done?

James Richardson: The Green Investment Bank was particularly important in offshore wind. I think it was probably less so in the other sectors it was active in; it did not really make a big difference in, say, energy from waste or energy efficiency, where it did some lending but was quite small-scale. In offshore wind, partly because it acted at scale and partly because it was a technology at that point where there needed to be investment but it was quite untried, the Green Investment Bank did play a significant role.

The EIB also played a role in that, if you look across Europe as a whole. You cannot prove it absolutely definitively, but there is a reasonable case and line of argument that those investments catalysed earlier development of those technologies, and that has then been clearly key in bringing down the price and making it much more viable to deploy these renewables at scale in a cost-competitive way. The GIB and also the EIB in offshore wind had a significant impact.

In terms of the privatisation of the GIB, offshore wind itself is probably now past that point of being an untried technology and can probably stand on its own legs, if you will pardon the pun. The question would be about what the next technology in line is that has those kinds of characteristics. In the environmental area, that might be charge points for electric vehicles, say, or it might be technology around decarbonising heat, which is clearly going to be quite challenging. You are probably not going to find a market institution, in terms of a privatised GIB, solving a market failure problem. You would not expect to see that. I suspect that the Green Investment Group, as it now is, will continue to be active in offshore wind, and that will be fine, but it does leave a gap in terms of the next technology.

Lord Giddens: Is its remit going to be more international? Is that suggested now that it is a private agency or private investment fund?

James Richardson: Yes, although in a sense it can grow. Freed from the constraints of the Treasury's balance sheet, of course, it can engage in a wider set of activities that do not necessarily crowd out its activities in the UK. I am not sure that those compete, but it would be optimistic to assume that you can solve a market failure with a privatised institution. That probably comes back as a challenge for whatever is next in the line of technologies, and those are not necessarily green technologies.

The challenge of climate change is so great that there are almost certainly new green technologies for which you will want this kind of function, but, as Phil said a minute ago, in terms of rolling out of fibre, you are in that position again where it is just not clear what the market is and therefore you may want this kind of support for a period. That would

have been outside the remit of the Green Investment Bank anyway, but it would be something that, say, the EIB has invested in across Europe.

In terms of the lessons you might learn from that, if you were to establish a new institution, it might look relatively similar to the Green Investment Bank. We have looked at a broader remit in terms of infrastructure and not just the environmental challenges, though they will loom large. Certainly you would want a body that is independent, is expert, is able to make its own decisions on what to finance and is able to tackle these market failures around new technologies. All of those were features of the Green Investment Bank that you would want to roll into any new institution.

Lord Giddens: Thanks. That is a very comprehensive answer.

Lord Desai: Was it a mistake to set up a bank just for green technologies? Was it, almost like Lord Cavendish was suggesting, a specific project bond, as it were, for offshore wind? You set up a bank, and then that it is all that it does. Would it not be better to have merged it into a business bank or something like that and set up a proper multipurpose infrastructure bank?

The Chairman: Were you involved in those decisions at the time?

James Richardson: I was not involved in those decisions, no.

Lord Desai: Innocent.

James Richardson: In retrospect, the ambition was to be broader than offshore wind. The reality was that, in terms of the projects needing that kind of finance at scale, there were not none but they were not at scale in other areas. It did cause some constraints then with the state aid provisions, because it needed to fit within state aid and that kind of constraint in what it could do. If it had had a slightly wider remit across all of infrastructure, it might have been able to move on to something like fibre that was outside its green remit but would have met state aid. In some senses, you are always slightly trying to get the right boundaries for institutions, and they do inevitably change over time. They were trying to do the right thing.

Phil Graham: Coming back to this point about capability, knowledge and the ability to carry out due diligence and stamp of approval, et cetera, there will always be a balance to be struck between your ability to get this thing up and running, as a capable and knowledgeable organisation that will provide this, and your desire to take a wide view. It would make sense to at least start with not necessarily a remit that would be as narrow as offshore wind but a remit that is focused and allows you to focus your capability in that area.

The Chairman: We are coming to that a little later.

Q7

Lord De Mauley: You recommend in the National Infrastructure Assessment that the Government should retain access to the EIB if

possible. Is that realistic? How would it work? Are there benefits in addition to access to cheaper finance and that such funding does not count towards public sector net debt? Of the sectors that you mentioned earlier, which specific ones would be particularly affected by the loss of EIB funding?

James Richardson: Let me try to start at the end of that list and work back, because it is probably where the balance of our thinking is more developed. There are benefits beyond just the balance sheet treatment, because you have an established institution and the expertise, and people in the markets understand what it means if the EIB is willing to co-invest. You would have to recreate those with a UK-specific institution, and that inevitably takes time and has transaction costs. There are advantages of sticking with an institution that broadly has been successful—I am not sure in every degree—and is well understood and has capabilities. There is that as well as the balance sheet treatment; whatever one thinks of the balance sheet treatment, it is clearly a factor.

In terms of the sectors, you would have to look at in two different ways. In terms of what we think of as the core benefit of this in terms of new and emerging technologies and infrastructure classes, it is probably things like electric vehicle charge points and full fibre, where you are bringing through new infrastructure types and potentially some further new technological development in the electricity generation space; floating offshore wind might be where we were 10 years ago with fixed offshore wind.

In terms of the sectors that just borrow quite a lot of money from the EIB because it is cheaper, you would have to look at the water and sewerage sector. I find it hard to believe that those projects could not be financed elsewhere. It is a regulated asset base and a pretty stable income stream. These are bankable projects, but they may have to pay a slightly higher rate for that, and that will inevitably feed through to consumers depending on the way the regulator treats the cost of capital. Those would be the impacts.

We did not specifically look ourselves in great detail at the modalities of how this relationship might be maintained. We talked to a lot of people who know more about the state of negotiations with the European Union than we do, and it did not seem sensible for us to stick our oar in, if you like, to that negotiating process. Certainly, people who are close to it told us that, yes, this was a realistic thing to be aiming for. It might not be a realistic thing to achieve, of course, but it was not an absurd thing to look at. Of course, the EIB lends to quite a number of countries outside of the European Union, including developed economies such as Norway and Switzerland, albeit the scale of that is relatively small compared to the size of the UK market.

Q8 Lord Cavendish of Furness: I do not know to what extent you have already answered this. It is about the possibilities of the UK keeping access to the EIB. Given that you said that there are non-EU countries, is there such a thing as partner status?

James Richardson: As I say, we have not looked at this in detail, but there are mechanisms that the EIB currently uses that involve lending to countries with developed economies that economically look a lot like the UK outside the European Union. In a sense, where there is a will there is a way. As I have said, the challenge in all of this would be scale; the UK is just very big compared to Norway or Switzerland, and the impact of that on the balance sheet of the EIB without the UK's capital would be something that would have to be worked out. It is not something that is fundamentally different from activities that the EIB already does in scope.

Lord Cavendish of Furness: Presumably, if there were political fracturing, of which Brexit is part, and that were to spread, the institutions such as the EIB would want to stay put and try to mend it.

James Richardson: It may be a little beyond our remit as the National Infrastructure Commission to worry about political fracturing.

Lord Cavendish of Furness: Yes, but it is on the horizon.

Q9 **Lord Thomas of Cwmgiedd:** Could we look at the alternative in case what is a political question does not come off? You say that we should look to establish a UK institution by 2021, and suggest consultation by the beginning of 2019. Would you be able to explain what needs doing? 2021 is not that far away. Could you explain the detail, and then I might want to ask you one or two questions?

James Richardson: Yes. We have based the timeline on the creation of the Green Investment Bank, which was created on very similar timescales. That is why we think that timescale is realistic. In some ways, it would be a little easier in that you have the model of creating a Green Investment Bank to work on. In terms of the legal framework, the governance structures, the scope and so on, there is a lot of the stocks, if I can put it that way, that you can build on.

This was less true in 2010; work had been done, but you are now starting in a more advanced position understanding how you would do that. It looks to us to be a realistic timetable. You would clearly have to develop terms of reference, scope, governance and so on, which would be slightly different from the Green Investment Bank. Because you are looking at a different institution, you would have to decide how much capital the Treasury was willing to put into it and so on, but these things are not beyond the wit of man.

Lord Thomas of Cwmgiedd: Do you envisage it would require legislation? If you required something that was autonomous and not interfered with politically, it surely would need legislation.

James Richardson: I am not a lawyer, but I think that is probably right.

Lord Thomas of Cwmgiedd: Second, if one therefore is to set about this, presumably someone ought to be drafting a consultation paper almost immediately.

James Richardson: Yes. In order to be able to publish it in spring 2019, you would certainly want people to be starting on it.

Lord Thomas of Cwmgiedd: And to work out what legislative structure you need. Presumably you would also have to address the question as to whether anything could be done to take it off the public balance sheet.

James Richardson: Inevitably, that discussion would be had. I suspect that in practice it would be very difficult to take it off public sector net debt as a measure. These discussions were no doubt had about the Green Investment Bank, but the definition of public sector net debt makes it pretty hard to escape for an institution of this sort. It may be better to spend your time thinking about how you manage the implications of that. It would not be the only thing the Government do where you have something in PSND that is matched by assets but the assets do not net off; I am thinking of something like, say, student loans, which are much bigger in scale than this probably would be.

Lord Thomas of Cwmgiedd: Obviously, your message is to get on with this now, to put it bluntly. When it is all planned out and the timelines are developed, should we also think of some interim solution in case it is delayed? Getting legislation through at the moment is not that easy a prospect, as I know from trying to move things completely unrelated to Brexit.

James Richardson: Our sense is that if you can do it on the timetable that we have set out, we have not envisioned a need for interims. That goes partly back to the question Lord Desai asked. They are not as good, but you can do things, out of the Treasury or the Infrastructure and Projects Authority, to ensure, as it were, that finance flows to some of these new technological areas. The Government are trying to establish a financing vehicle, for example, for electric vehicle charge points directly on the Government's balance sheet without an institution.

In some senses, there are vehicles out there, similarly on fibre, that ought to be capable of providing a stopgap until you have established an institution. Clearly, if the Government concluded that it was going to take five years to set up an institution, they might need to think about whether they needed more such vehicles or to merge them into a single fund run out of the Treasury. I am sure you are all much more capable of taking a view on parliamentary arithmetic than I am.

Lord Thomas of Cwmgiedd: I have one very short last question. Is anything actually underway, in so far as you are able to tell us?

Phil Graham: There have already been announcements about some of the measures that the Government are proposing to take to plug this gap.

Lord Thomas of Cwmgiedd: I meant in terms of the creation of an independent institution.

Phil Graham: You would have to ask the Treasury exactly what is happening. They are thinking very hard about the implications of losing access to the European Investment Bank and were very keen to engage with us as we were doing this thinking. Whether that has got as far as drafting a consultation paper I could not tell you, but there are certainly people in the Treasury engaged in this very question.

- Q10 **Lord Cavendish of Furness:** I want to ask about the question of a new institution. It shows my age a little, but my life experience would suggest to me that an institution takes about 10 years to come of age and develop a culture and authority in one way or another. In fact, having served on quangos, I have noticed that the Government very often destroy one quango and reconstitute it precisely to stop one from getting too much power. Can that process be now speeded up?

James Richardson: You are right to say that there is an institutional lifecycle, and to develop all the expertise, culture and so on would take longer than the time it takes simply to establish the body. Equally, you can look at the Green Investment Bank experience and say that this body was set up relatively quickly and did have a material impact on the offshore wind market within a relatively short period of time. You may not get all of the benefits of a well-established body—and of course that is one of the arguments for retaining access to the EIB; you just get to keep that—but, equally, you are certainly getting capability before 10 years. Maybe we would say that; we are an institution that is slightly shy of our third birthday.

- Q11 **Baroness Neville-Rolfe:** You have touched on this already, but how much capital would actually be required for a new UK infrastructure finance institution to perform the functions that we are going to be losing from the EIB? How does that compare with the amount of current capital contribution to the EIB?

James Richardson: We have not made a specific estimate. It would depend on the flow of new technologies requiring support and, on the point that Baroness Falkner made about the potential for a countercyclical role, you might need more capital at that time. Broadly speaking, you are looking at a balance sheet that is certainly in single figure billions. If you look at what is private sector investment in infrastructure in the UK, the ONS figures that came out a few weeks ago suggest an order of magnitude of around £10 billion per year. Maybe you are going to be supporting 5% to 10% of that per year, it is not all innovative, the institution is co-investing, and there is a tenure of perhaps 10 years of average. That would give you a broad sense of scale.

Clearly, if you saw some very large new technology that needed a great deal of support, you might need that to expand, and at some times it might contract. If you had another big financial shock, you would want to be able to expand that. That would probably come in at less than the UK's capital within the EIB, which is I think about £35 billion. Is that right? You probably know.

The Chairman: There is a percentage figure of 16%, but I do not know.

James Richardson: It does not come back under the agreement that has been done until quite a long time away, but it is a sizeable sum of money.

Baroness Neville-Rolfe: There is a financing gap, then.

James Richardson: There would be a timing question, but in terms of the aggregates, actually our paid-in capital to the EIB is probably greater than the balance sheet that this institution would need to hold. The EIB has a broader scope, of course; it covers a bunch of sectors that we are not looking at, so it is not an apples-and-apples comparison.

Baroness Neville-Rolfe: Would a UK institution require more upfront capital because it is less diverse and there is no geographical diversification? Would that make it more difficult?

James Richardson: I am not sure it would overall. Yes, you have more concentration in geography. On the other hand, you are not lending to parts of the world that are probably somewhat higher risk than the UK. I suspect that probably washes out. Undoubtedly, going back to what Phil said earlier, the ability to manage the portfolio and ensure that across the portfolio as a whole this institution is not losing money is a key part of why you want an institution with an independent board. You would need to ensure that it was set up in such a way that sound banking was one of the principles that applied, so it does not make a loss on the public balance sheet.

Baroness Neville-Rolfe: I had another question on financing. Is there any scope for non-financial assets, which obviously you would have in a normal business, or bringing in private finance, or indeed some of the other ideas that you had in your helpful chapter 7 around rates, road charging and all of this sort of thing? Could you see the institution having those sorts of sources of finance?

James Richardson: It could certainly engage in activities that were beyond simply equity or bonds. Financing guarantees would be an obvious thing. You might want to roll the UK Guarantees Scheme into it, for example; that would not show up on the balance sheet. Actually, part of its role might be in technical assistance and so on, which are not directly financial contributions. Its role would be somewhat wider, and it would have the potential to have broader instruments. These are obviously the things you would put in your consultation, but you could imagine it having a wider range of instruments, not all of which would score directly in the public finance aggregates.

On the question of the institution itself borrowing in the financial markets, it could do so; KfW in Germany does, for example. But it is not going to affect the treatment of the balance sheet on public sector net debt. Whether it raises its money in the private capital markets or it gets it from the debt management office, as it were, it is all going to score in

public sector net debt exactly the same. Again, you are trading off the fact that if it issues its own bonds, they are less liquid and are probably going to trade at some premium to gilts. KfW trades at a small premium to the federal Government in Germany.

There is a cost to it doing that. Is there a commensurate benefit in terms of the kinds of disciplines that brings? You would have to be confident that there was for there to be a case for it to issue its own finance. It is not a crazy idea—KfW does it and Transport for London has done it—but there is a cost to it, so you would have to be clear that the benefit was there. It does not get you around these questions of the balance sheet. It is all going to score in the PSND.

Baroness Neville-Rolfe: Leaving the balance sheet on one side, what about some of these additional funding mechanisms that you identified in your report?

James Richardson: You would not want a financial institution to be managing road user charging, but clearly if you had road user charging, then that potentially makes new road schemes bankable. It solves the challenge that you have with some infrastructure that does not have a funding stream. This is used quite widely in a number of continental countries where you can finance the road construction privately because there is an income stream.

Q12 **The Chairman:** I just have a quick point. We have looked up the notes, and actually the UK's shareholding in the EIB is just around €2.5 billion.

James Richardson: Okay. That is less than I thought.

The Chairman: It leads me to a quick question. Lord De Mauley wants to come in after that. You have mentioned the Green Investment Bank and the, in a sense, off-the-shelf experience that we might be able to replicate. What was the initial funding of the Green Investment Bank?

Phil Graham: It was £3.5 billion. My understanding of the EIB money is that we have a commitment to provide up to somewhere in the £30 billions, but only £3 billion to £4 billion has actually been called upon and brought into the bank. I may have misunderstood.

The Chairman: Following on from those thoughts, you, Mr Richardson, commented on how the EIB's scope of work is different, broader and more diverse, and of course its scale is much bigger. What do you think would be the need, in terms of capital start-up and accessibility, for a new infrastructure bank similar to the EIB?

James Richardson: If you are looking at the infrastructure scope as we have looked at it, you are not looking at a figure that is wildly different from those £3 billion or £4 billion numbers. We have not made a specific estimate of it, but it would be of that kind of order of magnitude. What you are not getting there, of course, is social infrastructure: schools, hospitals, housing and so on. Those are out of our scope, so I cannot comment on it. In terms of making the comparison, obviously it is

important to understand that there are a whole bunch of activities the EIB does that this institution would not. That would be lost to the UK and that financing would need to be found in some other way if the equivalent projects were to go ahead.

- Q13 **Lord De Mauley:** Acknowledging the other points about liquidity, costs of funds, expertise and so on, and looking specifically at the public sector net debt question, is there an argument that the EIB is funded from members states' contributions, which funds, one could argue, have come in marginal terms from government borrowing, and so, to an extent, those contributions will have counted towards PSND, or is much of the EIB's own balance sheet funding private sector funding?

James Richardson: The distinction between the way the EIB scores and the way a domestic institution scores, as I understand it, is that the paid-in capital from the UK to the EIB I am virtually certain would score in PSND. Of course, the EIB then leverages that by itself borrowing in private markets, and that borrowing by the EIB on its own balance sheet does not score in the balance sheet of any of its member states. It is a little bit of fiscal magic, whereas for a UK-specific institution, whether it borrowed privately or through the DMO, its entire balance sheet would sit within PSND.

- Q14 **The Earl of Lindsay:** You mentioned the GIB as being one template, as it were, that you can draw on in terms of creating a new infrastructure institution in the UK. You obviously know very well how the EIB works, and that may be another source of inspiration in terms of how you might design the UK institution. You mentioned KfW a moment ago. Do you want to give us a feel for the templates that are out there beyond GIB that you can use in designing a new institution for the UK?

James Richardson: There are a number of bodies of this sort. What is interesting in a sense is that they all do somewhat different things. There is not one model that you would necessarily pick up, but certainly you can learn from the things they have in common, and to some extent the things they have that are different. You have national institutions like KfW, which provide a much wider range of financing support than just infrastructure. There is an argument about whether all of that is additional relative to what the domestic financial institutions in those countries could do, but it certainly includes the kinds of activities that the British Business Bank is intended to provide that are beyond infrastructure. There is a Japanese development bank, which is relatively similar in some ways. You then have the multilateral bodies. You have the EIB, but you also have the Nordic Investment Bank, and then you have the more development-focused World Bank, EBRD and so on.

They all have somewhat different scopes as to their lending. The more common features—and the things that you particularly learn about—are about the benefits of a clear mandate, independent governance, and principles around sound banking and additionality. Their treatment in the balance sheets of various states also varies somewhat. The German Government use a different fiscal aggregate, which means that KfW does

not show up there. It is also not subject, for some reason that I do not pretend to be an expert on, in quite the same way to state aid provisions as the Green Investment Bank was. There are some of these quirks. You would have to understand in establishing a new body what was available. It is not clear that the KfW state aid provisions would be consistent with whatever deal we do or do not do with the European Union on trade, so you would have to get through all that complexity.

The Earl of Lindsay: If you look at all of those international and national examples, does one stand out, or do one or two stand out in particular, as being obvious reference points as to how the United Kingdom might want to develop its institution?

James Richardson: I do not think it does in the sense that you want to pick the German model or the Scandinavian model. It is more the things they have in common that we have looked at and said those things seem to be characteristic of successful bodies of this sort. It is partly inevitable that they are often a product of history. KfW was very much part of the reconstruction effort in Germany after the war. The Japanese development bank came out of the response to the tsunami. The EIB was very much part of the establishment of the European Union. There is a lot of history involved in the establishment of these bodies that you cannot simply replicate in the UK in terms of their scope. These questions around governance, mandates and so on are more universal, and that is what you would predominantly want to learn from.

The Earl of Lindsay: Can I also ask about the Scottish Government's plan to create their own national investment bank and how you would anticipate a UK-wide infrastructure financing institution and a Scottish national investment bank?

Phil Graham: Broadly speaking, at the moment, the plans for the Scottish national investment bank are focused very much more on the British Business Bank-type element of its proposed remit. If you read the consultation papers that have been published, there is a lot of detail about how it would lend to SMEs and the potential funds that might be affected. There is a note—it is more than a note; it is a couple of paragraphs—about the fact that it could also play what they call a mission-focused role in lending to infrastructure, but there is very little detail about how that would play out.

In a broad sense, in terms of whether that could coexist with a UK infrastructure investment institution, if it did choose to follow through on that mission-focused route and do the large investment, the answer is undoubtedly yes. That is visible from the fact that these institutions exist at all kinds of scales across the globe. KfW exists alongside the European Investment Bank. If you look at the United States, there is a federal infrastructure support mechanism; they do not actually have a federal bank of this kind, but they provide central support of various kinds, and alongside that a number of states have set up investment institutions of their own. The idea that these things cannot operate at different levels

and that those relationships cannot be managed does not feel to me like it would be an issue.

- Q15 **Lord Vaux of Harrowden:** We have been talking about setting up a new institution. What alternatives might there be to establishing a new institution, and in particular could the remit of the British Business Bank be expanded to fill the gap?

James Richardson: In a sense, you can always establish institutions in a number of different ways, but the direct overlap between the activities of the British Business Bank and those we would anticipate here is quite limited. The British Business Bank is predominantly focused on small and medium-sized companies and venture capital, whereas this would predominantly be larger investments with different risk profiles, different types of projects, longer lifespans, regulated assets and so on.

The overlap in terms of the kinds of skills and activities is pretty limited. When we looked at it, it did not seem a kind of obvious fit. It is clearly the case that institutions like the KfW, or indeed the EIB through the EIF, combine both of these things. Could you put them both under an umbrella? Yes, you clearly could. Are there huge synergies from doing that? It is not obvious.

Lord Vaux of Harrowden: Are there other alternatives to a new institution and other ways of financing?

Phil Graham: The other alternative is that you rely on private finance. One of the important things to note about this is that, in a lot of cases, the EIB is providing finance that could potentially be provided perfectly well by the private finance markets if lending to well-established, well-capitalised organisation such as Thames Water, which would not find it difficult to find alternative sources of funding. There is a question about whether that would be at the same rate, but then there is a question mark about whether it should be the Government's job to provide cheap finance to Thames Water in the first place.

Alongside that, there are schemes such as the guarantee scheme that the Government have put in place and that they have announced that they are expanding to help manage some of these risks. The challenges there, which are what led us to the conclusion that there is a case for a targeted investment institution, are those around capability and independence, and this factor that came across quite strongly, particularly in offshore wind, that an organisation that has that capability and knowledge, and is seen as expert provides that due diligence and provides that first stamp of approval that can crowd additional private sector finance as these technologies and innovations become more established.

It is important to be clear that this is not a choice between establishing an independent institution and completely filling the gap, or not doing so and the whole thing disappearing. There is a spectrum here. If you did not establish an institution, there would be large chunks of the gap that

could be filled in other ways. We think there probably is a portion at the end where a new institution could make a tangible difference.

- Q16 Lord Butler of Brockwell:** The EU is planning a new organisation called InvestEU in the next budget period to consolidate its financing instruments, and in particular to take over from the European Fund for Strategic Investments. We understand that it envisages the possibility of a partnership relationship for non-EU countries with that InvestEU organisation. Do you think that might take over some of the role that the EIB has been fulfilling?

James Richardson: I do not know enough details about what exactly they are proposing. The EFSI has essentially operated from the European Investment Bank. That has played a role in infrastructure financing, although a lot of what it has done has been around small and medium-sized businesses. If in that way it is a programme, then potentially that programme plays a role. The question, obviously, is about the institutional structure that is being proposed. Is it actually part of the EIB? Is it part of the Commission? You may have more details on it than I do.

- Q17 The Chairman:** I have just another question to pick up on all of those earlier discussions we had about the public sector net debt. Given that you would have to have it on the books, would it constrain the size of UK infrastructure finance given the Government's objective? It is a purely technical question. The then Chancellor, Mr Osborne, announced first that we were going to bring down public debt by 2020; now it is 2025. Given your experience in the Treasury, will this be a hurdle to setting up a bank in the UK?

James Richardson: If the Government continue to use public sector net debt as their measure of debt, then it is clearly a concern. It is not necessarily a showstopper. If you look at something like student loan policy, it has some similarities. It shows in the debt figures and it is a large sum of money. The Government have chosen to accept that and in some ways sell some of these off, but it is still taking quite a substantial element on to net debt because that has benefits for the economy as a whole. That would be the Government's argument. You would not say the Government could not do this simply because it has some impact on net debt, but it is going to show up in the arithmetic and therefore compete with other uses of the Government's balance sheet.

It is not completely clear, at least to me, what fiscal measure the Government will use beyond the existing debt target, which I think is for 2020-21. There are other aggregates: general government gross debt is the main international measure and that is what is used for the Maastricht criteria and by institutions such as the IMF—an institution almost certainly would not score in general government gross debt, because it would be a public corporation and public corporations are outside. That is why, say, KfW does not score in Germany. However, it is fair to say that the Government have moved away from GGGD and might think it is a retrospective step to exclude things from the balance sheet.

There is also a measure that this Government have asked the ONS to introduce, public sector net financial liabilities, which would capture both the liabilities but also the assets. You would expect those essentially to balance, so in that sense it would be on the balance sheet but would wash out, and the effect on the balance sheet would therefore be neutralised. If the Government chose to move to that at some point in the future, that would have a different impact. At the moment, it is an experimental ONS statistic, but as it gets traction, it is something the Government may wish to look at. We are not here to advise them on fiscal policy, though I can give you the technical answer.

Q18 Lord Butler of Brockwell: Here is an old Treasury man asking another old Treasury man a question. Is the interest for the Government in the net debt target reducing the amount of interest on debt that the taxpayer has to finance? Is that not the significance of the net debt target: that you are trying to ensure that debt is financed by means other than the taxpayer?

James Richardson: That is certainly a key factor. You would expect an institution of this sort to make a return on this capital sufficient to pay the cost of the interest on the capital paid in. That would be a measure of whether it is investing wisely. You would not expect an institution of this sort to be adding to the aggregate debt interest in total. That is an important difference between this and, say, wider public spending. The Government do worry about the sheer scale of the public sector debt for broader macroeconomic reasons, and therefore anything that scores in it is going to raise some issues. They need to be balanced against the macroeconomic benefits of having an institution of this sort.

Lord Desai: It makes no sense to me as an economist that you compare debt to income, because one is a stock and one is a flow. There is no sense to it. You should compare the debt servicing to GDP or growth of GDP. By that criterion, as long as you can satisfy yourself that you can service the debt from the increment in income, who cares? Why should I care? That is the superior economic wisdom to what the world has been doing, because interest rates right now are historically low and there are a lot of sovereign funds waiting to invest in some good projects. I am sure if you gave them a good deal, they would buy, and the Government would be able to service that debt.

The Chairman: Mr Richardson, are you feeling out of your comfort zone?

James Richardson: My problem is I am feeling too much in my comfort zone but out of my institution's comfort zone. It is probably not a question for the National Infrastructure Commission.

Lord Desai: You can establish your reputation for being a sound person.

Q19 Lord Giddens: This question might be outside of your comfort zone or the comfort zone of the Committee. You have this huge flow of Chinese capital these days. You have the belt and road initiative, which is intruding deeply into Europe. It is pretty controversial, partly because a

lot of infrastructure involves digital methodology these days and the Chinese system is separate from the western system. I just wondered whether you had a view on the role of Chinese investment in infrastructure in the UK. The Chancellor has welcomed the belt and road initiative, but some of the other European countries are getting very iffy about it. I did not know whether you would be able to comment a little on that. There is huge Chinese capital available. Some have suggested the City of London might become one of the more core financing sets of institutions for the expansion of belt and road. It is intruding, but it is a huge issue for western countries, including this one, to think about.

Phil Graham: I will try to stay as far within my comfort zone as possible. It is not our job. Particularly within BEIS, the security aspects of different forms of investment in UK infrastructure assets is something that is being looked at.

Lord Giddens: Would you see Chinese investment playing a big role after Brexit in UK infrastructure projects?

Phil Graham: What we have tried to do is make recommendations that are about making it as simple and efficient as possible for investment to be delivered in UK infrastructure in an appropriately efficient and cheap way. Whether that investment comes from China, from sovereign wealth funds in other parts of the country, from other parts of the globe or from UK pension funds is simply not something that we have gone into. That is getting outside of the comfort zone.

Lord Giddens: Hinkley Point is not outside of your remit directly, obviously.

Phil Graham: The case for Hinkley Point has clearly been part of our remit. The strategic and security implications of the Chinese funding for Hinkley are not something we have looked at. We have clearly been interested in the means by which funding and financing for that project were identified, and we looked at that in terms of thinking about future nuclear as we planned the investment.

Baroness Neville-Rolfe: On the financing, I ended up a little unclear. I wondered, given that we are now doing this inquiry, whether there was anything you wanted to add in writing in terms of the capital requirements of a new institution, and whether there is a gap that has to be met in the way you have described, for example by the Treasury doing schemes, or whether in fact it is not that bad. If you were able to do that, it would obviously be very useful. I would find that really helpful.

James Richardson: We can have a go. We can certainly get the EIB numbers square and compare those with the GIB. What we have not done is made our own estimate of the capital requirements of this institution. That is something that would have to be part of the consultation, but we have not put our own figure on it, so I cannot give you something more than my single-digit billions estimate. We can certainly look at the EIB numbers and put that down for you.

The Chairman: Any other thoughts that you may have subsequent to this session, about how the UK might creatively come to deal with how to fill that EIB gap if we do not get a separate deal on the EIB, would be very helpful.

Thank you so much for your time; you have been very generous with your time, so we are very grateful for that. The Committee will now resume its private session and the public evidence session is now ended. Thank you very much, Mr Graham and Mr Richardson.