The case for a National Investment Bank

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This is a transcript of John McDonnell's address from his joint lecture with Professor Stephany Griffith-Jones on the case for a UK national investment bank, part of PEF's series of public lectures on macroeconomic issues.

I'm delighted to have the chance to talk about one of the central plans of our programme, bringing together Labour's policy programmes on finance, business and industrial strategy.

Many of you will know that we committed to establishing a National Investment Bank ahead of the 2017 General Election, and published an independent report with recommendations on how best to do so.

I'm delighted to see some of those who contributed to that report here tonight.

And I'll return to Labour's thinking in this area shortly.

But first I want to thank Stephany for her fascinating talk just now, and indeed for an advance copy of her book.

I've found the international perspective of her work particularly useful as we consider the best form for the UK's national investment bank to take.

Stephany has examined in detail the Asian Infrastructure Investment Bank and the German KfW, and her book launched tonight also draws on analysis of Latin American development banks, as well as developments in China.

There are two points to be made about this, relevant to the Labour Party's ongoing thinking about a national investment bank.

First, Stephany's work has highlighted that a national investment bank is not some new-fangled experiment. The United Kingdom is, if anything, fast becoming an outlier in not having one.

Second, there is much to be mined from historical experience, overseas and in this country, about what a good national investment bank should do, and what it should not do.

This kind of detailed research is highly informative as we develop the design features of a national investment bank fit for the twenty-first century.

I'll try and address two questions: why do we need a national investment bank?

And if it's such a good idea why doesn't the UK have one already?

To take the second question first: the political reaction has lagged, as so often, behind economic reality.

Neoliberalism, in this country and elsewhere, has deployed the rhetoric of smaller government in order to justify vicious cuts to vital services, while at the same time using tools of government to boost private contractors and fossil fuel projects.

In other words, the idea that the government should be 'hands-off' in the economy has been applied self-servingly and dishonestly around the world, though rarely more so than in the UK.

But after decades of political attachment to the doctrine that the state has no role to play in finance, the bank bailouts of ten years ago fatally undermined the argument that the market knows best.

And exposed the state guarantee that implicitly underlies banks which are "too big to fail".

We can, though, take some comfort from the fact that we are gradually winning the battle of ideas.

In recent years the neoliberal hostility to active government has been forthrightly challenged by progressive economists and campaigners.

As the hollowness of this Thatcherite neoliberal agenda has become clear, we have seen a return of academic interest in industrial policy.

There has been a shift in debates away from the question of *whether* government should be involved in steering economic development towards the more nuanced question of *how* a government should play that steering role.

So before I turn to how I believe a national investment bank should play this role, let's just remind ourselves of the reasons why it's needed.

The finance sector is simultaneously one of the UK's most significant industries and one of the most problematic.

We are one of the most imbalanced economies in Europe.

While Inner London has an average GDP per capita six times the European average, West Wales and the Valleys has a regional average only 68% of the European average.

We invest less than other countries, with the ONS reporting last year that our non-government investment was the lowest in the G7, and had been for the preceding fifteen years[1].

The British Business Bank reported that the proportion of SMEs applying for new loans fell from 2.9% in 2012 to 1.7% in 2017, many with little in the way of physical assets not bothering to apply as they know what the answer will be.

The UK's physical infrastructure is in poor shape, with transport amongst several sectors which have faced years of decline and neglect since privatisation, and the CBI amongst many others regularly highlighting the impact this has on businesses.

In particular, the government's complacency on environmental issues has meant we lag far behind other countries in developing and diffusing sustainable sources of energy generation.

New solar power installations halved two years in a row following the Government's cuts to subsidies[2].

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[1] https://www.ons.gov.uk/economy/grossdomesticproductgdp/articles/ananalysisofinvestmentexpenditureintheukandotherorganisationforeconomiccooperationanddevelopmentnations/2018-05-03

[2] https://www.theguardian.com/environment/2018/jun/19/uk-solar-power-growth-halves-for-second-year-running

Meanwhile, as GFC Economics' report to the Labour Party last year made clear, the banking system is taking deposits from manufacturers and building up huge lending portfolios for real estate.

To give one example, in the first quarter of last year, "professional, scientific and technical" sectors had a £69billion deposit surplus, and manufacturing had £15bn, while "buying, selling and renting of real estate" had an £83billion lending surplus[3].

So with the challenge in mind, what sort of mandate should a UK national investment bank have?

Our report from 2017 recommended focusing on a few areas.

Addressing the long-term funding gap for small and medium sized enterprises.

Supporting the development of physical and social infrastructure.

Funding technological research and innovation, in which the UK still lags behind many other economies.

Helping to rebalance the UK economy away from London and the South East.

As well as supporting other socially valuable services as assigned by the Government, including our manifesto commitment to at least double the size of the co-operative sector.

Driving the work of our National Investment Bank through a network of regional development banks will allow greater in-depth knowledge of local economies.

While simultaneously using the central power of the national bank to take a macro view of the areas where finance should be directed, including into areas of the country which are underserved by the current financial system.

In order to achieve that goal, our report recommended an initial injection of twenty billion pounds from Labour's national transformation fund, with the NIB then issuing its own bonds and building up its balance sheet to achieve a target of around two hundred and fifty billion pounds of lending after ten years.

Alongside two hundred and fifty billion of additional government investment over the same first two terms of a Labour administration, that could make a huge difference not just to the UK's economic growth rate but to the form that growth takes.

Among the bank's mandate areas mentioned just now, perhaps the most significant is the potential for supporting our industrial strategy.

Many of you will know the work which Rebecca Long-Bailey and Chi Onwurah have been undertaking in this area for Labour.

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[3] https://labour.org.uk/wp-content/uploads/2018/06/Financing-investment-final-report-combined.pdf (p. 81)

And the debt which we all owe to the work of Mariana Mazzucato.

Because one objection often raised to a national investment bank is the idea that providing more finance will not necessarily address the shortage of profitable ventures seeking that finance.

This misunderstands the arguments in favour of state investment banks in at least three ways.

Firstly, through its position as a state guaranteed institution, the bank can raise its own finance more cheaply than private banks and pass those low interest rates onto companies.

There will be a number of concerns or potential concerns for whom a loan at 5% and a loan at 20% makes the difference when deciding whether to get started, expand, or close down.

Secondly, there may be expansion plans which require long-term patient investment, which a national investment bank with a mandate to make a profit, but not seek short-term profit maximisation, can make where others can't.

And finally, by being part of the government's industrial strategy, the national investment bank can be part of not just fixing markets but creating and shaping markets.

The question of "what is profitable" is not a neutral one.

And when the state is already involved in much of the research being done in the UK – though receiving little back in return for its support – surely it makes sense to use that power to drive the kind of growth we need in the areas we need.

By creating opportunities for new firms, co-operatives and other organisations to thrive in new sectors, the state can create more takers for the national investment bank's lending.

And those who already underwrite the transition to the economy of the future – the taxpayers of the UK – can see some of a return on their investment.

Nowhere is this clearer than in the urgent need for a step change in our attitude to climate change and potential environmental catastrophe.

Of course, the impetus for decarbonising our energy sector must – and under Labour will – come directly from government investment.

The idea that governments can simply privatise and subsidise their way out of the most complex and perilous challenge faced by any generation, is simply gross negligence, and arguably one of the biggest policy failures of the last generation.

Yet the transition to sustainability will create markets for new goods and services at home and abroad.

These can be built and delivered in Britain as part of a Green Jobs Revolution, and the national investment bank will be a key part of that.

Because there are a few key points that can't be emphasised often enough.

It cannot be a disguise for straightforward fiscal policy: though endowed with initial capital by government, day-to-day decision-making must be independent of government.

Only if observers believe that the NIB is not acting as an arm of the Treasury will they trust it to make the right decisions and to have the reputation which the best state banks have earned, gaining them even greater access to more finance.

But while the national investment bank must be profit-making, it should not be profit-maximising.

Even with an active industrial strategy shaping incentives, there will always be the potential for a state bank to make the same mistakes as private sector banks can and do: prioritising quick returns instead of long-term lending; favouring lending only against tangible assets; and getting into complex derivatives which can threaten financial stability.

Taking forward all the ideas and proposals coming forward from those here this evening and others, including Peter Rice who unfortunately is in New Zealand, is now forming a major part of our preparing for government work.

Having a detailed instruction manual to lay on the desk of civil servants on day one of a Labour government is a huge task, but one which is well underway.

Thanks to some who are here tonight and others who aren't, we're testing the ideas in our 2017 report, developing them further, and integrating them with other proposals which have come forward on, for example:

Our Strategic Investment Board…

Keeping RBS in public ownership…

And investigating the possibility of using the Post Office network to establish a Post Bank.

Thank you to everyone who is helping or has helped Labour with that work.

Thanks also to all the speakers this evening, and thanks to PEF for organising it and inviting me.