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DESIGNING THE NATIONAL WEALTH FUND

A NEW VISION FOR UK PUBLIC FINANCE

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The government's mission to get the UK economy on track and achieve the fastest growth in the G7 will only be delivered by significantly powering up investment in Britain's booming green economy. The National Wealth Fund will be a critical pillar of this approach if its mission from the outset is to drive private investment into the clean growth industries of the future.

With economies around the world recognising the net zero opportunity, and increased competition for green investment, governments are moving swiftly to establish comprehensive packages of public investment to drive clean growth. The most notable of these is the US Inflation Reduction Act which has unlocked hundreds of billions of dollars in private investment and supported over 300,000 new jobs in only two years.[1] The UK's new National Wealth Fund (the Fund) has the potential to transform the UK's growth prospects by delivering catalytic investment and crowding in significant private investment. Achieving this requires the fund to add value to existing UK public finance institutions to accelerate the green growth sectors of tomorrow.

Based on analysis of green bank design processes in the UK and other countries, E3G's latest briefing sets out:

> The case for a clean National Wealth Fund.

> Key design questions for the Fund and lessons to be learnt from the UK Infrastructure Bank (UKIB).

> Recommendations for mission, objectives and institutional structure options.

> Creating the right enabling conditions for the Fund to deliver.

[1] The White House, August 2024, **Fact sheet: Two years in, the Inflation Reduction Act is lowering costs for millions of Americans, tackling the climate crisis, and creating jobs**

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Key recommendations for the National Wealth Fund

Recommendations to the Chancellor at the October 14th Investment Conference:

> **Establish the Fund's clean growth mission.** The Fund's objectives should include:

- Driving net zero and resilient growth.
- Supporting good jobs and a just transition for workers.
- Boosting the UK's industrial competitiveness and productivity by ensuring the UK is an attractive place to produce clean goods and services.

> **Launch a sequencing roadmap for the design of the National Wealth Fund, with a clear timeline for consultation and policy development.**

> **Use this opportunity to appoint an independent expert with sufficient public banking and innovative financing experience to lead the design process** and commit to a period of active stakeholder engagement with a broad range of actors to support the design process. A Chief Investment Officer could be appointed during this interim stage to manage the fund within the UKIB to ensure it delivers capital effectively.

Recommendations relating to the structure and functioning of the National Wealth Fund:

> **Consider seeding the Fund as a "mission-led shadow fund" within the UK Infrastructure Bank**, to support swift delivery of the Fund's public investment. This would enable the Fund to leverage existing institutional support and expertise while distributing initial investments, without locking the Fund into a specific structure prior to appropriate consultation to answer critical design questions.

> **Grant the Fund the authority to deploy catalytic capital with a higher risk tolerance** than typically seen in the financial sector. A flexible risk tolerance will enable the fund to deliver catalytic investment above and beyond the existing capabilities of UKIB and other institutions., while not necessarily limiting the Fund's ability to make a return for the taxpayer. This approach has been successfully deployed by leading impact development banks and VC funds – and the Fund could learn from best practices through the proposed consultation process.

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Recommendations relating to enabling environment for the Fund:

> **Commit to an urgent review of the impact of fiscal rules on the capitalisation of UK public banks**, including looking at international best practice to understand how any liabilities issued by the Fund and the UKIB can be excluded from measures targeted by fiscal rules like public sector net debt (PSND).

> **Embed the Fund within a coordinated, coherent policy framework** to ensure its investment decisions can support a clean Industrial Strategy, underpinned by a whole-of-economy Net Zero Investment Plan. Active coordination with key government departments (HMT, DESNZ, DEFRA and DBT) is required to ensure the necessary policies are in place to support the delivery of the Fund's objectives.

> **Establish a representative advisory body**, including political, investment, real economy, academic and CSO stakeholders, to provide expert advice to guide the effectiveness and evolution of the UK's public finance landscape.

The case for a clean National Wealth Fund

Following a welcome consultation process with financial actors through the National Wealth Fund Taskforce, the government has indicated that the National Wealth Fund will focus on driving the transition to a low-carbon economy. That transition is the UK's "economic opportunity of the century",[2] at a time when the country faces significant economic challenges. As the National Wealth Fund Taskforce (the Taskforce) identified, to deliver net zero and capitalise on that opportunity, annual low-carbon investment must increase to £50 billion by 2030.[3]

UK GDP in real terms is just 2.3% above pre-pandemic levels (compared to 3.9% in the EU and 9.4% in the US).[4] Productivity growth is lower than in France, Germany and the US,[5] primarily due to a prolonged lack of investment in capital and skills. UK companies have invested 20% less than those in the US, France and Germany since 2005, placing Britain in the bottom 10% of OECD countries for private investment, and costing the economy 4% of GDP.

[2] Rt Hon Chris Skidmore MP, **Mission Zero: Independent Review of Net Zero**

[3] Green Finance Institute, July 2024, **National Wealth Fund Taskforce**

[4] Daniel Harari, House of Commons Library, October 2024, **GDP – International Comparisons: Key Economic Indicators**

[5] John Van Reenen and Xuyi Yang, POID, June 2024, **Cracking the Productivity Code: An international comparison of UK productivity**

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The UK faces international competition for green growth opportunities. The global economy is moving towards net zero and in response, industrialised nations are providing significant public funding to catalyse growth in key industries – particularly in clean energy, transport, and manufacturing. Most notably, the US Inflation Reduction Act[6] has unlocked hundreds of billions of dollars in private investment and supported over 300,000 new jobs, just two years from its enactment.

The Climate Change Committee estimates that the UK could create up to 725,000 new jobs in low-carbon sectors by 2030,[7] the majority of which will be outside of London and the southeast. The CBI estimates that clean growth opportunities such as electric vehicles, heating and insulation could add between £37 billion and £57 billion, or 1.6–2.4%, to UK annual GDP by 2030.[8]

As the National Wealth Fund Taskforce (the Taskforce) identified, to deliver net zero and capitalise on these opportunities, annual low-carbon investment must increase to £50 billion by 2030.[9] Public investment in vital green industries, embedded in a full-economy Net Zero Investment Plan, will be needed to crowd in the private investment that will enable nascent UK innovations to move from technological viability to commercial reality. It will be essential that the Fund underpins an ambitious green industrial strategy, as public and private investment will only drive the UK's green economic transformation if it is delivered alongside a strategic package of enabling policy interventions.

The government has stated that the launch of the Fund will be used to align existing public finance institutions and will focus on driving the transition to a low-carbon economy.[10] The interaction between the Fund and the existing UK public finance institutions will be critical to consider as part of the design process, and this is covered in the following chapters of this paper. This is particularly case with the newly launched GB Energy (GBE),[11] and the existing UK Infrastructure Bank. The remits and relationship between the Fund and these

[6] The White House, 16 August 2024, **FACT SHEET: Two Years In, the Inflation Reduction Act is Lowering Costs for Millions of Americans, Tackling the Climate Crisis, and Creating Jobs**

[7] Climate Change Committee, May 2023, **A Net Zero Workforce**

[8] CBI, 2023, **Going for Green: The UK's Net Zero Growth Opportunity**

[9] Green Finance Institute, July 2024, **National Wealth Fund Taskforce**

[10] Gov.uk, 9 July 2024, **Boost for new National Wealth Fund to unlock private investment**

[11] Gov.uk, **Great British Energy**

[12] Upgrading ports to be renewable-ready (£1.8bn in this parliament); green hydrogen manufacturing (£500m in this parliament); transitioning the steel industry (£2.5bn over ten years); decarbonising industry (£1bn in this parliament); new gigafactories to ensure the future of the UK's automotive industry (£1.5bn in this parliament).

institutions must be clearly defined to ensure additionality and effective delivery of investment.

Initial funding has been allocated to selected sectors,[12] providing helpful signalling to the market. However, the investment needs and sectoral priorities for the green transition will continue to evolve. The Fund must therefore be designed from the outset to be mission-driven and additional, with the flexibility to invest in sectors beyond the initial allocations. This requires careful consideration of the current landscape and of the key design questions for the Fund, to ensure that it is set up to deliver lasting impact.

Mission and objectives for the National Wealth Fund

The National Wealth Fund must be established with a clear mission that is additional and complementary to the mandates within the existing UK public finance ecosystem. That mission should be to deliver transformative investment into green industries of the future. Specifically, the Fund's objectives should be established in legislation as:

> Drive net zero and resilient growth.

> Support good jobs and a just transition for workers.

> Boost the UK's industrial competitiveness by ensuring the UK is an attractive place to produce clean goods and services.

To deliver on these objectives, the Fund should be given a broad mandate to deploy a flexible investment strategy designed to catalyse private, public and blended investment into clean industries. This would enable the Fund to pursue an investment strategy designed to address market failures, and act as a de-risking vehicle to crowd much-needed private investment into the UK.

While private capital mobilisation will be vital, to deliver on the wider objectives listed above a more holistic way of measuring success must also be embedded from the outset. In previous submissions to the UKIB, E3G has proposed KPIs around emissions savings, number and quality of jobs created, and new technologies supported.[13] Given the Fund's additional mandate of crowding in

[12] Upgrading ports to be renewable-ready (£1.8bn in this parliament); green hydrogen manufacturing (£500m in this parliament); transitioning the steel industry (£2.5bn over ten years); decarbonising industry (£1bn in this parliament); new gigafactories to ensure the future of the UK's automotive industry (£1.5bn in this parliament).

[13] E3G, 2 March 2022, **Joint letter to UKIB on KPIs**

private investment, consideration should be given to metrics which assess this objective in addition to the clean and competitive objectives. Broad approaches have been used by a host of public finance institutions globally, including the German development bank KfW, the European Investment Bank, and the Nordic Investment Bank. The Fund could consider engaging with relevant international institutions to adopt best practice in its investment strategy, and performance assessment. This could also include learnings on building internal incentive structures to encourage delivery of this 'triple bottom line'.

Recommendations

- **The Fund's mission must be drawn up considering the gaps in the public finance ecosystem.** It should have broader objectives for the use of public funds to support industrial decarbonisation and a just transition.
- If the National Wealth Fund is to have a long-term impact, the government must learn the lessons from the UK's privatisation of the Green Investment Bank and **put in place an explicit commitment from government as to its longevity and independence**. Establishing the fund's mandate in legislation will help ensure that its institutional focus is long-term and that decision making, internal incentives and external buy-in are supportive of its mission and goals.
- **The Fund's investment strategy** (including clarity on what it will and won't invest in, and a Do No Significant Harm safeguard) **and KPIs should be established and communicated early on** – to ensure that the incentive structure within the Fund aligns with its overarching objectives. This should include consideration of the best 'crowding in' and blended finance approaches to support effective investment delivery – including consideration of metrics to measure the types of financial actors mobilised by the fund.
- **The Fund's performance must be regularly assessed with a holistic set of impact metrics**, which reflect the Fund's role as a critical vehicle for supporting nascent green industries while delivering jobs and supporting new technologies. These metrics must have equal weight to any rate of return expectations to ensure that returns alone do not dictate the investment strategy. The Fund could consider engaging with relevant international institutions to adopt best practice in its investment strategy, and performance assessment.

Key design questions for the Fund

Public finance institution design should be considered a cycle that can be iterated.[14] Effective public finance institutions can grow and evolve over the long term and must have the capacity to innovate within their mandates to address emerging priorities.

Through analysis of green bank design processes in the UK and other countries, E3G has identified five phases of green bank creation (Figure 1).[15] Within this framework, under a new Labour government and given the work of the National Wealth Fund Taskforce, this institution is currently in the Design phase.

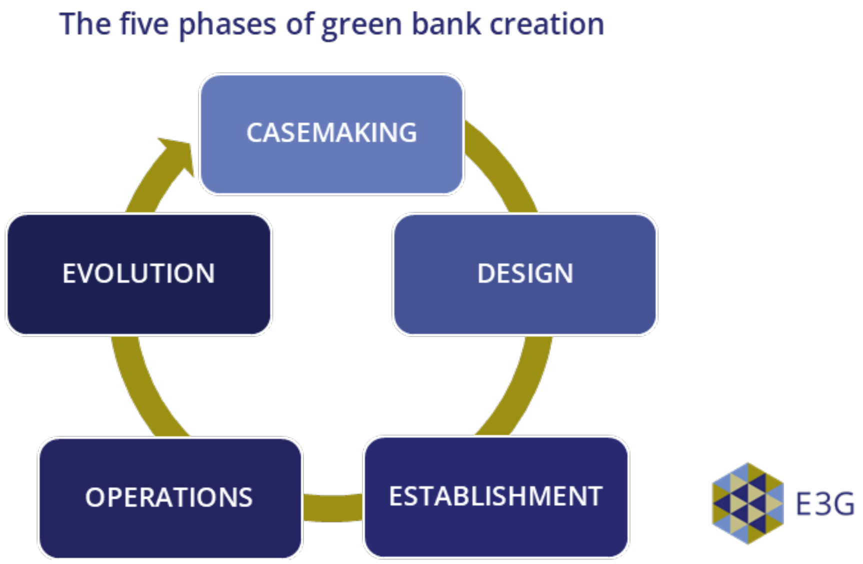


Figure 1: Through previous analysis of green bank design processes, E3G has identified Five phases of green bank creation (Naidoo, 2019[16]). The National Wealth Fund is currently in the Design phase.

At this stage in the Fund's development, the following steps must guide the Fund's learning process to ensure its integrity and effectiveness:

> **Defining a mission statement setting out the Fund's overarching purpose and reason for existing.** This will act as a link between each future stage in the learning process, ensuring that the institution remains focused on its core

[14] E3G, February 2021, **National Infrastructure Bank Design: Building a Public Bank Fit for the Future**

[15] E3G, July 2019, **Green Bank Design Principles: A synthesis of E3G's learnings from building green banks**

[16] Naidoo, C. (2019). Greening the Development Bank of South Africa: 1988 to 2019. An Evolutionary Approach

purpose as it develops. This will enable setting of specific objectives and KPIs that the Fund will seek to achieve to meet its mission.

> **Ensuring that the initial form of the institution is appropriate and effective**. This is especially important in this case given the tight timeline for deployment. Consideration is required of the optimal institutional structure, capitalisation and mandate needed to achieve the fund's mission.

> **Considering the existing landscape of UK public finance institutions in choosing the Fund's mission, objectives and institutional form.** This should include their mandates, roles in the technology maturity curve, and market barriers that remain in need of addressing. Government has indicated their intention for existing institutions to be 'aligned' under the Fund.[17] The relative merits of this and alternative models must be closely considered as part of the design process.

> **Coordination with government departments such as HMT, DESNZ, DEFRA and DBT** to ensure that the necessary policies are in place to support the delivery of the Fund's objectives on the one hand, and that the Fund itself is aligned to support the UK's emerging industrial strategy on the other.

Key design questions for the Fund

Based on the steps set out above, Government should build on its initial consultation with the Taskforce to ensure the institution is designed in consultation with a wide range of expert stakeholders. This stakeholder consultation process will be essential to ensure that the Fund is effective in the long term, and builds trust across the market, while delivering broad economic benefit across Britain. This process should focus on answering the following questions:

1. What are the desired outcomes from this institution? In particular, how can the Fund drive green prosperity across the UK, adding value to local economies, and creating jobs and clean industries in the communities that they support?

2. How can the Fund best support the policy objectives of HMT, DBT and DESNZ to decarbonise energy and industry in an affordable way that protects jobs, drives growth and maintains fiscal responsibility?

[17] Gov.uk, 9 July 2024, **Boost for new National Wealth Fund to unlock private investment**

3. How can the Fund support the reversal of flatlining public and private investment in a way that is additional, i.e. not likely to be accomplished in status quo conditions?
4. What are the functions of the institution and what structure is required to deliver these functions? What governance and institutional structures does it require to be effective over time?
5. What is the appropriate scale of capitalisation over time, for different sectors? How is the capitalisation going to be financed?
6. What sectors will be considered eligible for support, and how should entities in those target sectors adapt over time to maintain market confidence and meet wider socio-economic and environmental goals?
7. How can the institution be given a long-term flexible mandate to ensure it learns from doing, and evolves its approach as the investment landscape changes?
8. How will the institution work with the existing network of public finance institutions, government bodies and business funding mechanisms?
9. What additional policy support does the Fund require in order to (increase the feasibility of) achieve(ing) its aims?

Recommendations:

> The Chancellor should use the UK Investment Conference on 14 October to **announce a sequenced roadmap for the National Wealth Fund's design and establishment**. The government should take this opportunity to appoint an independent candidate with sufficient public banking and innovative financing expertise to lead the Fund design and set up process.

> **A formal stakeholder input body should be created** to enable expert input from financial and real economy institutions, trade unions, civil society and academia. This consultation process will be essential to ensure that the Fund is designed effectively from inception – and that it builds trust across the market, while delivering broad economic benefit across the country.

> To ensure the Fund is guided in its mission in the long term, **a representative advisory board should be established** alongside to advise on the policy and economic outcomes of the Fund. This group should convene political, investment, real economy, academic and CSO representatives, to provide advice on the effectiveness and evolution of the Fund and the UK's public

finance landscape. This body should have a formal forum for consultation with the Industrial Strategy Council to ensure alignment.

> **In the short term, the Fund could be established with a clear mission as a "shadow fund" within the UK Infrastructure Bank.** This was the approach taken when establishing the UK's Green Investment Bank.[18] In this setup, the UKIB could appoint a Chief Investment Officer for the fund. This would enable the Fund to distribute initial investments swiftly in alignment with a catalytic investment strategy without locking it into a specific structure prior to appropriate consultation to answer critical design questions, and the parameters of the new government's "mission-led" industrial strategy are established. Running as a shadow fund in the first instance would also buy time for valuable stakeholder engagement and communication with the market without losing immediate opportunities for impact.

Positioning the National Wealth Fund in the existing UK public finance landscape

There is currently a shortfall in the investment that is needed to scale up innovative, high-impact solutions for reaching net zero in the UK. This is leading to opportunities being missed to support the growth industries of the future, as we have seen in offshore wind manufacturing.[19] Risk-tolerant and flexible capital is required to bridge this gap, and ultimately attract private investment into sectors that might otherwise struggle to secure funding due to the perceived risk of lower financial returns.

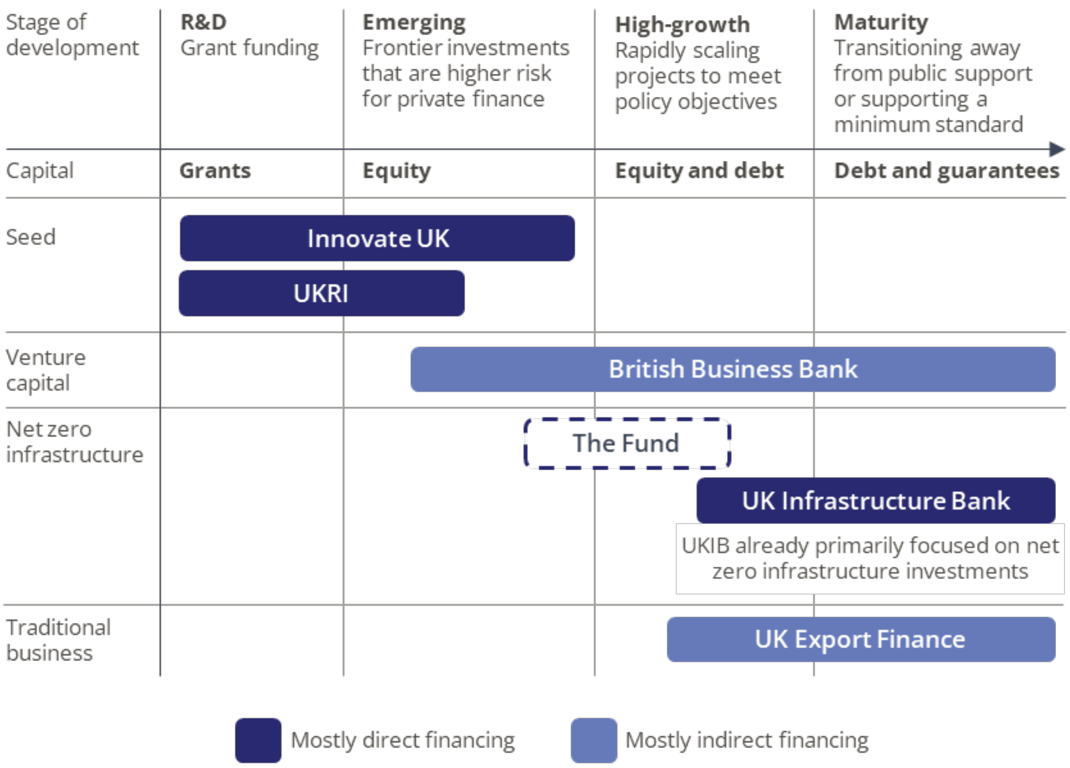
The UK has a number of public finance institutions with different remits. A summary of the current landscape of public finance institutions is set out in Figure 2, alongside more detail on their mandates in Table 1. In designing the Fund to tackle market barriers and deliver its mission, it is essential that the UK learns lessons from international peers, as well as from the work of existing UK institutions. It will be critical that the launch of the Fund helps to consolidate UK public finance, while allowing investment to be effectively deployed to deliver a step change in the ambition and impact of the public finance infrastructure.

[18] E3G, 25 April 2013, **Green Investment Bank: The history**

[19] IPPR, 7 June 2024, **Revealed: Billions at stake and net zero goals threatened as UK falls behind in the race for wind manufacturing**

The Fund must also be staffed with specific expertise to deliver on its mission. To effectively make catalytic investments and strategically take greater risks, experience in impact management and investing found more commonly at development banks and in the impact investing sector will be required. Best practice on developing a catalytic investment strategy could be ascertained through a consultation process.

The current landscape of public finance institutions in the UK



Other government funding sources include Scottish and Welsh finance institutions: Banc and The Scottish National Investment Bank

Source: Adapted from Infrastructure Bank, June 2022, Strategic Plan 2022

Figure 2: The UK already has a number of public finance institutions with different remits. The Fund needs to be complementary to the existing institutions, and have its own clearly defined remit.

Table 1: Mandates of key UK public finance institutions

Organisation	Description	Type of support
UK Infrastructure Bank (UKIB)	Government-owned policy bank with £22 billion of financial capacity across its private and local authority lending arms. Its mission is to partner with the private sector and government to increase infrastructure investment to help to tackle climate change and promote economic growth across the UK.	Senior debt Mezzanine / first loss finance Guarantees Equity
British Business Bank (BBB)	Government-owned economic development bank. BBB supports access to finance for smaller businesses to drive sustainable growth and prosperity across the UK, and to enable the transition to a net zero economy.	Debt Guarantees Equity
UK Research and Innovation (UKRI) & Innovate UK	UKRI is a non-departmental public body of the UK government that directs research, innovation and skills funding. It brings together seven disciplinary research councils, Research England which is focused on higher education institutions, and the UK's innovation agency, Innovate UK.	Grants Innovation loans Investor partnership Knowledge sharing Research commercialisation Investor readiness
UK Export Finance (UKEF)	UKEF is the UK's export credit agency. Its mission is to advance prosperity by ensuring no viable UK export fails for lack of finance or insurance, doing that sustainably and at no net cost to the taxpayer.	Export guarantees Debt (for overseas buyers) Guarantees (for overseas buyers)

Lessons from the experience of the UK Infrastructure Bank

In designing the Fund to deliver its mission, it is essential that the UK learns lessons from international peers, as well as from the work of existing UK institutions. As a case study, we highlight some lessons from the functioning of the UK Infrastructure Bank (UKIB). These are derived from market and civil society feedback, together with E3G's analysis of international best practice, and the Green Investment Bank. E3G can provide further detail and analysis on request.

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The UKIB, established in 2021, is a UK government-owned policy bank, with HMT as its sole shareholder. The Bank was a welcome addition to the UK landscape – delivering £1.1bn over 2022–23 to green sectors across the UK. With £22 billion of financial capacity across its private and local authority lending arms, its statutory mission is to deliver infrastructure investment to help to tackle climate change and promote economic growth across the UK.

UK Infrastructure Bank case study

1. **Appropriate capacity/expertise**. It is critical that all public finance institutions build sectoral and technical expertise to enhance investment decisions and develop the right instruments to maximise the impact of their investments. Establishing the full staffing and institutional capacity for UKIB took 2-3 years – so careful consideration is required for how the Fund can leverage existing infrastructure and hire the right sectoral and public banking expertise if it is to prioritise swift delivery.
2. **The importance of mission, and tackling the catalytic capital gap**. UKIB's return mandate, and high-ticket size, has meant that it has in its initial stages limited risk appetite for nascent and high-risk investments. Moreover, the absence of a National Net Zero Investment Plan means the UK government lacks strategic insight as to where public funding can deliver greatest bang for buck. The Fund should be established from the outset with a higher risk appetite and flexible financing approach to ensure it can provide innovative financing and catalytic capital to nascent sectors. Innovative blended finance structures to support fund delivery.
3. **Coordination with other public banks and public funding mechanisms**. The landscape of UK PFIs is diverse and complicated with institutions overlapping in their scope. PFIs also often overlap with other public funding pots. Coordination and clarity is required so that entities seeking public finance are clear on where and how they can find the support needed. Government should develop a coordination mechanism (i.e. MoUs between institutions with clear exit strategies) to ensure clarity and flow of information on which institution is best placed to support.
4. **Capitalisation.** UKIB was originally capitalised at £22bn, with £5bn equity, £7bn debt and £10bn in guarantees, enabling it to distribute much-needed funding for a variety of projects. However, without

market confidence in national policy direction, and the small scale of UK public finance relative to comparable economies, ensuring bang for buck from UK PFI requires it to be supported by a smarter, whole-of-economy approach. Government should carefully consider how it can scale up capitalisation over time, including reviewing how bank capitalisation is limited by existing fiscal rules. Other public banks such as KfW have the power to issue their own government-guaranteed debt. This and wider options should also be considered.

5. **Technical assistance and market development.** UKIB's advisory function, focused on local authority support, was a welcome addition to the UK space following the removal of EIB's IRENA. This is a critical resource for technical assistance to local authorities. The Fund could leverage this to expand the package of support across the UK, including establishing a market development hub, working directly with private finance to share knowledge and collaborate to overcome market barriers. E3G and UK100 previously published specific recommendations on updating the UK's technical assistance offer.[20]

Takeaways and recommendations for the National Wealth Fund

> **The new Fund must have the flexibility and impact investment expertise to take a diversified investment approach tailored to the needs of specific sectors.** UKIB is not currently positioned to fully play this role within the UK economy because its financial return mandate and high-ticket size restrict the ability for its financing to include higher-risk, earlier stage investment. An appropriate skills base and incentive structure will be required within the Fund to deliver this diversified approach. Learnings could be taken from consultation with impact investment experts from the public banking and private sector.

> **Specifically, the Fund should be granted the authority to deploy catalytic capital with a higher risk tolerance.** This will be essential to delivering a step change in the UK public finance landscape. This should be **accompanied by greater use of blended finance structures that can mobilise private sector capital.** The Fund must also be able to make equity investments, and a venture capital style functionality to manage risk and support early-stage sectors. Clear communication around risk tolerance and return expectations will be important, as will clarifying where the Fund's investments will sit on

[20] UK100, May 2022, **UKIB local authority lending and advisory service**

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the technology maturity spectrum and how its activity in each sector will fit into wider sectoral decarbonisation plans.

> **The Fund should learn from best practice in terms of finance mobilisation metrics,** including placing greater emphasis in its KPIs on capital mobilisation, and specific targets/metrics on the types of investors mobilised. **The Fund's CIO should ensure that the right incentive structure is in place from the outset to support an innovative financing approach to plug the catalytic capital gap.**

> To support effective scaling of new clean industries and meet the government's aim of catalysing growth in all corners of the country[21] **the Fund should be empowered to work with local partners** including local authorities and regional development funds, and to distribute finance through them. Where required, this should extend to being empowered to create new local institutional solutions, tailored to the economic needs of specific sectors and local communities. This strategic role and focus on working with local authorities specifically have been successfully demonstrated in Norway's KBN green bonds programme.[22]

> This should be accompanied by a **scaling of technical assistance support for clean growth projects across the UK**. This could be delivered through an update to the UKIB's advisory function – with an expanded remit to include a market development hub – to provide a hub of knowledge sharing and resources to support investment in the green sector.[23]

> **The Chancellor should launch a review of the way fiscal rules impact the capitalisation of UK public finance institutions.** Reforming the UK's fiscal framework, based on useful examples from international best practice, could unlock "additional public investment in climate change while retaining fiscal credibility".[24] Echoing CETEX analysis, the UK's current rules capture liabilities without taking account of the value of investments from the UK's public finance institutions. There is growing recognition within the academic community that this fiscal framework must be reviewed if the UK is to overcome its investment challenge.[25] Given the vital role public investment will play in driving growth and delivering the industrial strategy, all options must be explored to ensure the Fund, UKIB, GB Energy and other public

[21] Gov.uk, 9 July 2024, **Boost for new National Wealth Fund to unlock private investment**

[22] KBN, **Green Bonds**

[23] E3G, 13 May 2022, **UK Infrastructure Bank: Local Authority Advisory Service**

[24] Andy King, Daisy Jameson, CETEX, LSE, 11 July 2024, **Designing a UK fiscal framework fit for the climate challenge**

[25] FT, 16 September 2024, **Letter: UK national renewal requires step change in public investment**

banks have the resourcing required to deliver on their respective objectives in the short, medium, and long term.

Options for National Wealth Fund institutional structure

There is a significant opportunity for synergies if the Fund is designed in a way that clarifies and augments the UKIB's role in the ecosystem. A clear delineation of roles between the UKIB and the Fund, with an MoU established to define the relationship and clarity on the exit strategy of each institution, can ensure that these institutions are transformative in delivering UK policy goals.

The final decision over the model and structure of the fund should be shaped by the following principles:

> **Mission-first** – The Fund's strategy must be centred on delivery of its mission rather than delivery of sectoral funding allocations across a fixed list of sectors.

> **Additionality** – The Fund must be additive and complementary to the current ecosystem of UK public finance institutions. The Fund's final design must be shaped by a clear understanding of how it can fill the UK's catalytic capital gap.

> **Clarity to market** – The design and launch of the National Wealth Fund must be used to clarify the remits of all UK public finance institutions and where they sit along the investment pipeline. This must be communicated clearly to the market.

> **Flexibility** – The Fund must be designed to take a flexible investment approach, tailored to the needs of specific sectors to deliver impact. This could include regranting financing to other institutions, taking equity stakes, grant-based funding and competitive funding models based on need. This should be complementary and collaborative with existing public finance pots.

> **Ability to align with wider government policy** – The Fund must be designed to work within a coherent cross-government policy framework. The Fund will only deliver the required impact if it underpins the wider industrial strategy. The Fund must also be linked to the UK's broader Net Zero Strategy and sectoral pathways.

We see two primary options for how the Fund could be designed and structured to deliver on its mission. We summarise these below, including their relative merits and risks. The options should be consulted on widely as part of the sequencing roadmap mentioned above.

Option 1: The Fund as a newly established, over-arching strategic public finance entity

The Fund would be established as a new public finance entity, sitting above UKIB and all other UK public finance institutions and local authorities and funding bodies, with the power to distribute capital via these institutions.

The Fund would have a clear mandate at the head of the UK public finance ecosystem, tailored specifically to support key green industries and crowd in private investment. A new governance structure could be established to enable the Fund to deliver on its objectives effectively, with KPIs measuring environmental impact as well as financial returns.

This approach would enable a diverse and holistic UK investment strategy, closely linked to government policy objectives. The Fund would have the ability to distribute capital via existing institutions, and to diversify investments across various sectors, asset classes, and geographies without being constrained by UKIB's existing focus areas. The institution would seek to overcome the fragmentation of the existing UK public finance infrastructure, providing a clear market signal on the shift in public finance.

However, establishing a new entity would involve significant initial costs and time to set up governance, operational structures, and administrative processes. Given tight public finances and political debates over the value case for green investment, the Fund will need to be seen to be delivering relatively quickly to maintain political support. High setup costs and long delays could put this support at risk. Moreover, the market requires certainty to invest at scale – the initial flexibility of this initiative could be overridden by changing political incentives, thereby hampering long-term certainty. Under this approach it would be vital to ensure the Fund is guided in its activities through an advisory body complete with political, investment, real economy, academic and CSO representatives.

The UK currently has a catalytic capital gap owing to specific challenges within the existing ecosystem. While establishing a new institution has its benefits, careful consideration will have to be made as to how specifically the new institution will overcome this gap and avoid adding to previous fragmentation and lack of clarity around the UK government's strategy for net zero investment.

Option 2: The NWF as a distinct fund within UKIB

The Fund would be established as a dedicated fund, operating within the already established UKIB. This would be established via an amended mandate for the UKIB, setting out the specific remit of the Fund within the existing institution.

This approach would have the benefit of saving time and resources on establishing a new institution, with the UKIB already having existing capacity to learn and build from. In a challenging economic environment where investment in green industries is required to put the UK back on track to net zero, this would have significant benefits and allow impact to be demonstrated from a standing start. To ensure the Fund's investment strategy is complementary and additional to that of UKIB, an expert CIO could be appointed to manage this ringfenced fund.

Through working within the existing structure of UKIB, the Fund's remit could be clearly defined within the context of the existing ecosystem. Integrating the Fund within the UKIB would facilitate coordination of the respective investment strategies and help to ensure there is a clear public investment pipeline. This can help with delivering on high-level policy objectives.

However, a new Fund housed within UKIB would inherit the challenges around UKIB's delivery, expertise, and risk appetite that we have mentioned earlier in this paper. Placing a new fund within UKIB would require a new investment strategy and there would be question marks over whether the UKIB would be able to pivot effectively. The UKIB already has a focus on green investment, and there could be a lack of clarity over the additionality of the Fund in this context. Market stakeholders will be looking for absolute clarity to overcome any fragmentation, and therefore this presents a communications challenge.

The UKIB also has its own well-established independent governance processes. This would give government and/or the Fund limited control over its investment strategy beyond establishing its mandate and objectives. This could create challenges for ensuring the Fund is closely embedded in wider government policy, including the industrial strategy.

Recommendations

> Regardless of the final structure of the Fund and its role within UK public finance, the launch of the Fund must be used to clarify the specific roles of UK public finance institutions and how they will work together. This must include clarity on where each institution sits along the investment pipeline and its respective exit strategy for investments, as well as how they "hand over" investments to other institutions as industries grow and evolve. Communicating this clearly to market will be essential.

> With the Fund established in shadow form initially, the government must take time to explore the relative merits and risks of the two design approaches outlined above. This process must include external consultation with market stakeholders. The final design of the Fund must be centred around the key design principles of mission-first, additionality, clarity to market, flexibility and ability to align with government policy.

> The Fund must also commit to competitive funding mechanisms, learning lessons from the Contracts for Difference (CfD) model that has been adopted for offshore wind. This would seek to ensure that funds are distributed based on merit, fostering healthier competition within industries and delivering more sustainable outcomes. Rather than defaulting to established companies simply because they are currently capable of delivering on the aims of the fund, a bidding process should be introduced to invite companies to offer their most competitive proposals. By promoting competition, this approach will encourage innovation and drive better long-term results. This recommendation is supported by the National Workforce Taskforce report, which advocates for similar measures in their green steel section.

> Moreover, if the National Wealth Fund is to have a long-term impact, the government must learn the lessons from the UK's privatisation of the Green Investment Bank and put in place an explicit commitment from government as to its longevity and independence. Establishing the fund's mandate in legislation will help ensure that its institutional focus is long-term and that

decision making, internal incentives and external buy-in are supportive of its mission and goals.

Creating the right enabling conditions for the Fund to deliver

The National Wealth Fund will be established while the government also develops its industrial strategy to drive growth. For the Fund to deliver on its mission, it must be seen as a central engine of this strategy. The industrial strategy will set the UK's direction of travel economically, and this must be focused on clean growth. The potential net benefit to the UK's economy is £266 billion over the next 30 years, if the UK reaches its net zero targets.[26] Decarbonisation also provides a sustainable future for several high-emissions industries that have been in decline for many years in the UK.

This opportunity to transform the UK's policy and public finance framework promises dividends – driving the crowding in of private investment and delivering economic growth. Capturing these benefits requires the clean industrial strategy to be supported by a plan to unlock the investment required. This Net Zero Investment Plan[27] consists of:

> **Financial flow tracking:** an independent body such as the OBR monitoring and reporting on public and private financial flows towards key industries featured in the industrial strategy, highlighting investment gaps and market barriers.

> **Sectoral investment roadmaps**, which set out how the government will, through a combination of regulation, incentives, and strategic use of public finance, attract the private capital necessary to drive the transition to net zero.

These roadmaps, taken together, would set out a comprehensive delivery plan for the investment needed to deliver a clean industrial strategy, with tracking informing data-led policy course correction and the targeting of public finance. Figure 3 sets out a high-level overview of this policy framework.

[26] Department for Business, Energy and Industrial Strategy, 19 April 2021, **Impact Assessment for the sixth carbon budget**

[27] E3G, 27 September 2023, **Unlocking the economic opportunity of the 21st century through private finance**

Figure 3: Comprehensive National Delivery Plan for Clean Growth

Despite its value, upfront finance alone cannot deliver the systemic change needed to establish thriving low-carbon industries of tomorrow. There are three key areas for policy intervention both within and outside of the industrial strategy: market creation, supply-side policy, and competitiveness support:

> **Market creation mechanisms** are needed to create the strong business case investors need for investment in clean technologies. Green Public Procurement criteria, as suggested by the Taskforce, would provide a direct demand signal for low-emissions industrial products, such as green steel and cement. Meanwhile, mandatory product standards would limit the embodied emissions of certain goods sold on the UK market, providing a regulatory pull for investment in industrial decarbonisation.

> **Supply-side policies** must be implemented to ensure that businesses have the capability to produce low-emissions products or adopt clean energy solutions. Funding alone cannot deliver the transition to a clean economy. A coordinated Strategic Spatial Energy Plan must identify when and where the UK will develop clean power, green hydrogen, and CO_2 pipeline infrastructure (for capture, transportation, and storage). This will allow businesses and

investors to make their own climate transition plans, for example port operators will understand the roadmap to adopting clean shore-power, and industrial businesses can make informed decisions between electrification and hydrogen. Relatedly, action to reduce clean power prices is crucial to making electrification cost competitive, while a strategic vision for hydrogen is needed to ensure supplies are available to industries that need them most.

> **Competitiveness support** is needed to prevent high-carbon imports from undermining investment in low-emissions industries. A more robust carbon pricing regime will be crucial. Firstly, a stronger ETS price can incentivise further investment by making low emissions technologies more cost-competitive next to high carbon alternatives that increase exposure to the Emissions Trading Scheme. Secondly, a carbon border adjustment mechanism (CBAM) will be needed to prevent carbon leakage – the risk of which will increase should the domestic carbon price continue to rise without an equivalent applied to high-emissions producers overseas. These measures will be pivotal to ensuring that the Fund can de-risk its own investments while encouraging more private money into its priority sectors.

Recommendations

> The NWF and the investment decisions it takes should be part of a full-economy Net Zero Investment Plan, made up of investment flow tracking and sectoral investment plans. This would underpin the industrial strategy and enable this critical public investment to be effectively targeted to secure maximum impact and crowd in private investment.

> The Fund's investments must be complemented by a comprehensive package of policy interventions to enhance the impact and attract private investment. Finance alone will not be sufficient, and the Fund's investments must therefore be supported by market creation, supply-side and competitiveness support interventions in priority sectors.

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About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

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