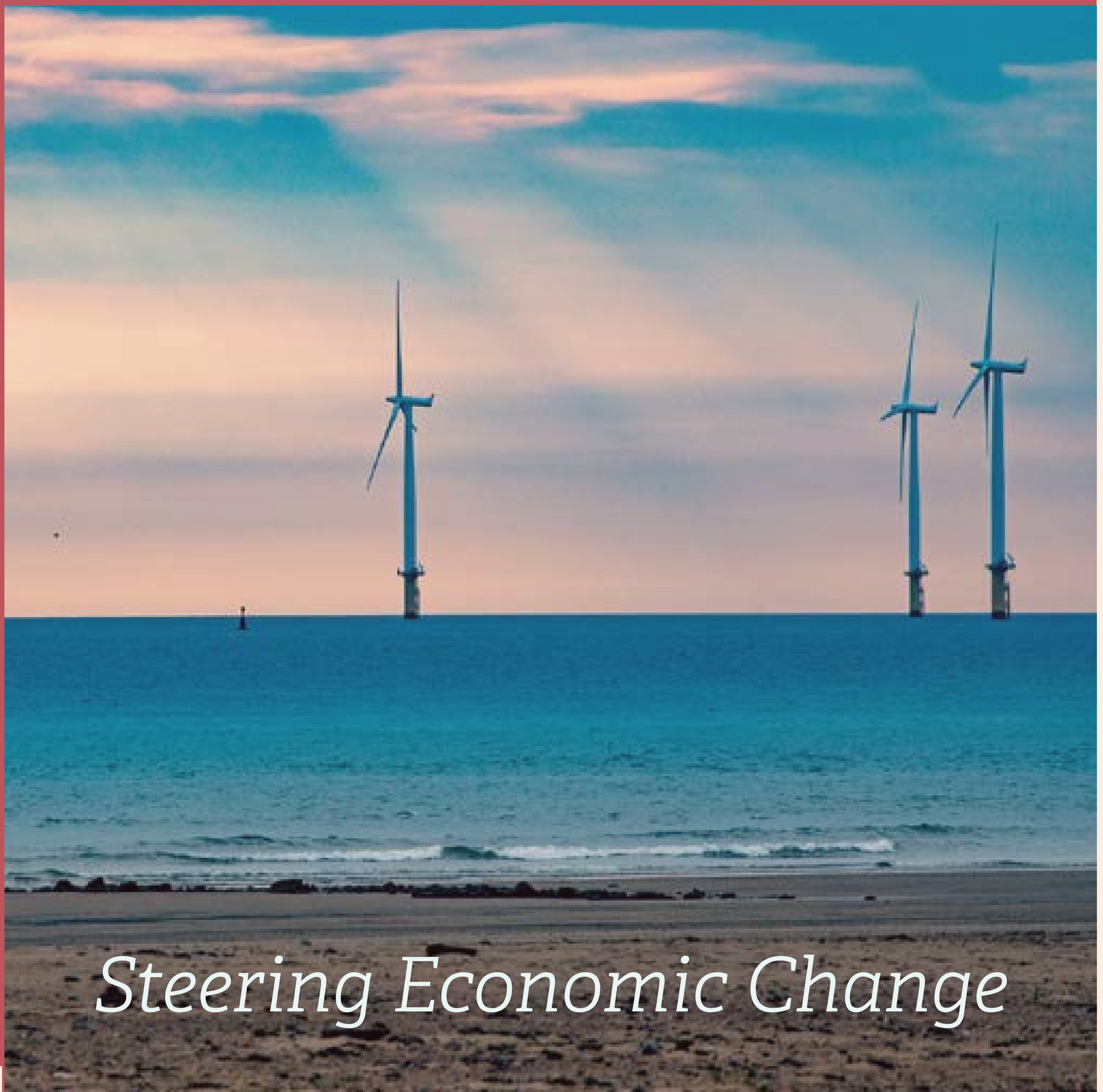
STEERING
Economic
CHANGE

THE
ECONOMY 2030
INQUIRY

Finance for the future

Practical solutions for the UK Government to mobilise private investment for economic, environmental and social priorities

Sarah Gordon & Anna Valero
October 2023



Steering Economic Change

As the UK is buffeted by the economic shocks and challenges of the 2020s, The Economy 2030 Inquiry, a collaboration between the Resolution Foundation and the Centre for Economic Performance at the London School of Economics (LSE), funded by the Nuffield Foundation, is setting out a new economic strategy. To feed into this process we are publishing a series of externally-written policy essays. Each aims to provoke public debate on a specific policy area, and sketch out an agenda that will contribute towards the wider goal of the UK becoming a higher growth, lower inequality economy.

The essays cover topics ranging from the role of smarter regulation in supporting economic growth, ensuring that the goal of 'good jobs' is embedded in our national industrial strategy, and the role of the higher education sector in providing the skills needed to power our services dominated economy.

They are written by a range of leading economists and policy experts, and reflect the views of the authors rather than those of the Resolution Foundation, the LSE or The Economy 2030 Inquiry.

They have been commissioned and edited by Gavin Kelly (Chair of the Resolution Foundation and member of the Economy 2030 steering group) and various members of The 2030 Economic Inquiry team.

The Economy 2030 Inquiry

The Economy 2030 Inquiry is a collaboration between the Resolution Foundation and the Centre for Economic Performance at the London School of Economics, funded by the Nuffield Foundation. The Inquiry's subject matter is the nature, scale, and context for the economic change facing the UK during the 2020s. Its goal is not just to describe the change that Covid-19, Brexit, the Net Zero transition and technology will bring, but to help the country and its policy makers better understand and navigate it against a backdrop of low productivity and high inequality. To achieve these aims the Inquiry is leading a two-year national conversation on the future of the UK economy, bridging rigorous research, public involvement and concrete proposals. The work of the Inquiry will be brought together in a final report in 2023 that will set out a renewed economic strategy for the UK to enable the country to successfully navigate the decade ahead, with proposals to drive strong, sustainable and equitable growth, and significant improvements to people's living standards and well-being.

Acknowledgements

This work has been supported by the Grantham Research Institute on Climate Change and the Environment, Schroders and The Harriet Collington Foundation. It provides a summary for the Economy 2030 Inquiry, drawing on a full report published on 23 October 2023.

It has benefited from input from nearly 100 individuals at 68 organisations, for which the authors are very grateful, as well as detailed comment from Jamie Broderick (Impact Investing Institute); Olivia Dickson (Collington Capital); David Hutchison (Social Finance); Brendan Curran (Grantham Research Institute, LSE), and Nick Robins (Grantham Research Institute, LSE). For comments and guidance in shaping this as a policy provocation for the Economy 2030 Inquiry, the authors are particularly grateful to Gavin Kelly and Jonathan Marshall at the Resolution Foundation, and Henry Overman and Nicholas Stern at the LSE.

The report and its recommendations are the sole responsibility of its authors.

Introduction

Investment in the UK, both public and private, is chronically low as a share of GDP compared to its peers. This has to increase if the UK is to see meaningful productivity growth, address regional disparities and meet its net zero climate commitments. Previous Economy 2030 Inquiry reports have made proposals for increasing public and private sector investment in the UK.[1]

Given the current weak outlook for growth, and constraints on the public purse, increasing the amount of private investment in the UK economy is an urgent priority. The Climate Change Committee estimates that getting to net zero alone will require additional annual investment in the UK of more than £50 billion by 2030, particularly in areas such as electricity supply, residential buildings and surface transport,[2] and the majority of this additional investment is expected to come from the private sector.[3] Moreover, a strategic approach is needed to ensure that the UK, its cities and regions can build upon current and potential strengths in fast-growing services and areas of high-value manufacturing.[4] This includes green technologies where – given the strong investment incentives being offered in the US and the EU – the UK risks falling behind.[5]

The Economy 2030 Inquiry has examined the reasons for low business investment in the UK, and previous reports have highlighted a range of features in the business ecosystem that must be improved.[6] As well as pointing to the importance of stability and clarity over strategy, the Inquiry has set out ways to rewire the UK's investment ecosystem across the board to deliver two core objectives: first, increasing firms' – or, more accurately, their management's – desire to invest in productive and sustainable assets; and second, enhancing their ability to do so. It has set out a range of policy actions across corporate tax, pensions, governance, the planning system and business support programmes to encourage business investment, including proposals to strengthen the institutions that govern growth policy to ensure that policies aimed at the long-term productive capacity of the UK can last.

Whereas this previous work focused on increasing the amount of investment in the UK, this paper presents complementary proposals on financing this in a way that can direct greater amounts of productive investment at pace into socioeconomic and environmental priorities. This includes net zero, where a number of market failures prevent private capital being deployed at the scale and pace required,[7] and where there are concerns that too much of the financing is passed directly to households (for example, through energy bill additions, such as the Renewables Obligation levy, or by the need to fund tax incentives). The proposals put forward in this paper set out how the public and private sector can work together to deliver funding solutions while placing a less disproportionate burden on taxpayers.

1 See: F Odamtten & J Smith, Cutting the Cuts, Resolution Foundation, March 2023; and: P Brandily et al., Beyond Boosterism, Resolution Foundation, June 2023.
2 Climate Change Committee, Sixth Carbon Budget Dataset, 2020.
3 OBR, Fiscal Risks Report, July 2021.
4 J De Lyon et al., Enduring Strengths: Analysing the UK's current and potential economic strengths, and what they mean for its economic strategy at the start of the decisive decade, Resolution Foundation, April 2022. See also: Brandily et al., A tale of two cities (part 1), A plausible strategy for productivity growth in Birmingham and beyond, Resolution Foundation, September 2023 and Brandily et al., A tale of two cities (part 2), A plausible strategy for productivity growth in Greater Manchester and beyond, Resolution Foundation, September 2023.
5 B Curran et al., Growing Clean: Identifying and investing in sustainable growth opportunities across the UK, Resolution Foundation, May 2022.
6 P Brandily et al., Beyond Boosterism: Realigning the policy ecosystem to unleash private investment for sustainable growth, Resolution Foundation, June 2023.
7 N Stern & A Valero, Innovation, growth and the transition to net-zero emissions, Research Policy 50 (9), November 2021.

To do so, it draws on tried and tested 'blended finance' approaches that have the potential to be swiftly replicated at scale. Blended finance relates to mechanisms whereby private capital generally in search of an investment return is combined with other 'catalytic' funding, often with a different purpose and risk profile, that mobilises the former towards investment in priority areas. In this report, it also describes a range of financial instruments which can be used to 'crowd in' private capital. These include the provision of first-loss capital or pure grants, co-investment to create scale in underinvested markets, guarantees and other instruments. These can be deployed alongside broader complementary policy instruments, such as tax credits, for the same purpose. Through blended finance approaches combining public and private investment towards this end, governments can take advantage of investors' appetite for savings and investment products that deliver positive socioeconomic or environmental benefits alongside capital appreciation or income yield.

The OECD defines blended finance solely in the context of emerging markets.[8] As a result, it has too often been defined as a tool for development finance, ignoring its relevance to developed markets like the UK. Emerging markets do provide the UK with useful testing grounds for a range of successful blended finance approaches, such as loan syndication platforms (e.g., the International Finance Corporation's Managed Co-lending Portfolio Program) or co-investment by government entities and commercial asset managers (e.g., the AfricaGrow fund, managed by Allianz Global Investors). The US and the European Union are now rolling out significant blended finance programmes (including as part of the Inflation Reduction Act as discussed below).[9]

Some of these approaches have already been used by the British Business Bank and the UK Infrastructure Bank, but such activities are still at a small scale relative to the country's investment needs.[10] As a result, institutional investors in the UK lack co-investment vehicles to encourage them to invest for public policy outcomes over the long term. The 2017 Patient Capital Review led by HM Treasury showed that a lack of longer-term investment in the UK prevents firms with high growth potential from scaling, and means enterprises are often sold to trade buyers before they grow to maturity.[11] By implementing the approaches outlined in this paper, the next five to 10 years could potentially see a far greater percentage of pension and insurance assets in the UK directed at productive investments for resilient and sustainable economic growth.

These assets are worth £4.6 trillion, and represent the second-largest pool of long-term capital in the world.[12] However, over the past 25 years, UK pension funds have reduced their allocation to equities overall, and to UK equities within that.[13] There is also scope to increase the flows of venture capital into scaling UK businesses. While the UK venture capital sector raised £25.3 billion of capital

8 The OECD say that: "blended finance is the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries. It attracts commercial capital towards projects that contribute to sustainable development, while providing financial returns to investors." OECD, Blended Finance Principles.
9 For more details on developing country examples as well as relevant US policies and instruments such as the Community Reinvestment Act, please see: S Gordon, Investing in our future: practical solutions for the UK government to mobilise private investment for economic, environmental and social policy priorities, Grantham Research Institute, October 2023
10 Impact Investing Institute, Estimating and describing the UK impact investing market, March 2022. A forthcoming report sets out 13 case studies from the UK and overseas, drawing out lessons from the UK. This paper provides a short, UK-focused summary. See: S Gordon, Mobilising private sector capital for public policy priorities: practical solutions for government, Grantham Research Institute, forthcoming October 2023.
11 Patient Capital Review, Industry Panel Response, October 2017.
12 W Wright, New Financial, Unlocking the capital in capital markets, March 2023.
13 P Brandily et al., Beyond Boosterism: Realigning the policy ecosystem to unleash private investment for sustainable growth, Resolution Foundation, June 2023.

in 2022, slightly above the 10-year average, only 15% of this total was invested in the UK.[14] Of venture capital investment in UK businesses, the share going to growth phase firms is lower than in the US.[15] Concerted action by the UK Government, the finance sector and civil society actors could take advantage of tried and tested models to address these challenges as well as mobilise private capital at the scale and pace required to address the UK's most pressing socio-economic and environmental priorities.

In the UK context, new blended finance options might call to mind the Private Finance Initiatives (PFI) in the 1990s and 2000s – long-term contracts between government and the private sector in public infrastructure projects that have been criticised for providing better value for the private sector than for the taxpayer. It is important to emphasise that, rather than create financing structures to shift public responsibilities off the public balance sheet, or to defer costs or liabilities for accounting ends, we seek to raise the Government's ambition to work effectively with private investors for public good, through collaboration, co-design and the use of investment vehicles which are appropriate and attractive to all parties.

Choosing the right blended finance instrument, or combination of instruments, is a critical part of the design process and depends on the policy objective and context. In this paper, we profile UK-based case studies in a range of sectors to demonstrate that, when deployed well, blended finance allows budget-constrained organisations to crowd in multiples of private investment to address pressing economic, environmental and social challenges. Several of the case studies also show the benefits of outcomes-based commissioning and financing, which, if more widely adopted, would enable government to deliver better results from its public spending decisions across departments.[16]

From these case studies, and from extensive discussion with key stakeholders, we bring our recommendations together into six 'enablers'.

First, building on proposals by political parties, think tanks and others for a growth 'super-fund', a new UK Growth Fund is proposed to help to attract pension and other large pools of institutional capital into impactful projects across energy, education, health, housing, transport and other sectors, with a target of £5 billion at launch (just over 0.1 per cent of the £4.6 trillion of assets potentially available[17]) and rising to at least £50 billion over five to 10 years. This fund will act as an umbrella vehicle for a portfolio of sector-specific funds that will each address market failures in individual priority areas for the UK's future prosperity and well-being. These funds will be designed to attract start-up and scale-up investors and will be incentivised to list in the UK on exit. It is estimated that providing investable opportunities in the UK Growth Fund's sector-specific funds could potentially attract an additional £10 billion of venture capital financing.

14 British Private Equity and Venture Capital Association, Performance Measurement Survey 2022, July 2023.
15 P Brandily et al., Beyond Boosterism: Realigning the policy ecosystem to unleash private investment for sustainable growth, Resolution Foundation, June 2023.
16 It is worth noting that this report is not simply describing an ESG (environmental, social and governance) investing approach nor the creation of ESG-specific funds or instruments. Despite ongoing challenges around measuring and accountability of such funds, ESG has established itself as a specific and useful sub-set of investment opportunities, focused on specific outcomes. Here, though, we focus on the creation of blended finance vehicles and approaches which can be effectively deployed by governments across a range of policy areas – not just those with an ESG focus - to crowd in private investment at scale.
17 W Wright, New Financial, Unlocking the capital in capital markets, March 2023

Second, a new UK Community Growth Fund is proposed to support small businesses, social enterprises and charities, building on precedents such as the £60 million Community Investment Enterprise Facility.

Third, these two funds should be managed by an existing government-owned institution, such as the British Business Bank or UK Infrastructure Bank, and overseen by a new unit in HM Treasury, which would also provide a centre of expertise on blended finance for central and local government.

The final three enablers would incentivise private sector investment into the new funds (and more generally): new guidance on fiduciary duty should be produced for institutional investors on impact investing;[18] the design of new incentives for investment in productive and sustainable assets in UK businesses should be reviewed; and there should be a reprioritisation of institutional mandates and incentive structures towards mobilising private sector finance at key government-owned UK institutions.

The two Growth Funds would take at least 12 months to launch. However, proposals for new guidance on fiduciary duty, and new investment incentives could be implemented quickly, and could swiftly unlock investment from institutional investors. Although public investment capital is available for the proposals set out in this paper – for example on the balance sheet of the UK Infrastructure Bank – the aims they set out to meet would be greatly facilitated by a review of fiscal targets as suggested elsewhere in the Economy 2030 Inquiry, in particular by setting a goal of improving public sector net worth.

The proposals set out in this paper present a range of benefits for policy-makers: better-funded projects and improved potential to deliver on key policy objectives; an enabling policy and regulatory environment in which more capital can be effectively and accountably dedicated to improving growth sustainably and equitably; and more robust bridges of trust and better ways of working between government, asset owners, the financial services industry, philanthropic funders, business and communities. Implemented together with a broader package of reforms to improve the business investment ecosystem in the UK, including institutional reforms to help reduce uncertainty, these proposals have the potential to substantially increase investment into attractive projects in the UK.

Blended finance involves a range of actors and a variety of instruments, depending on context and objectives

There are a number of barriers to mobilising private sector capital to help finance public sector initiatives. One is the risk (perceived or real) that such investments may involve - whether the risk of capital loss, uncertainty of return, or simply concerns about untested business models. Another is reconciling the different priorities of and outcomes sought by public and private investors: for example, in the case of housing investment, these might be improved conditions in social housing and a market-rate financial return. Examples from around the world show these investor concerns can be effectively addressed using blended finance.

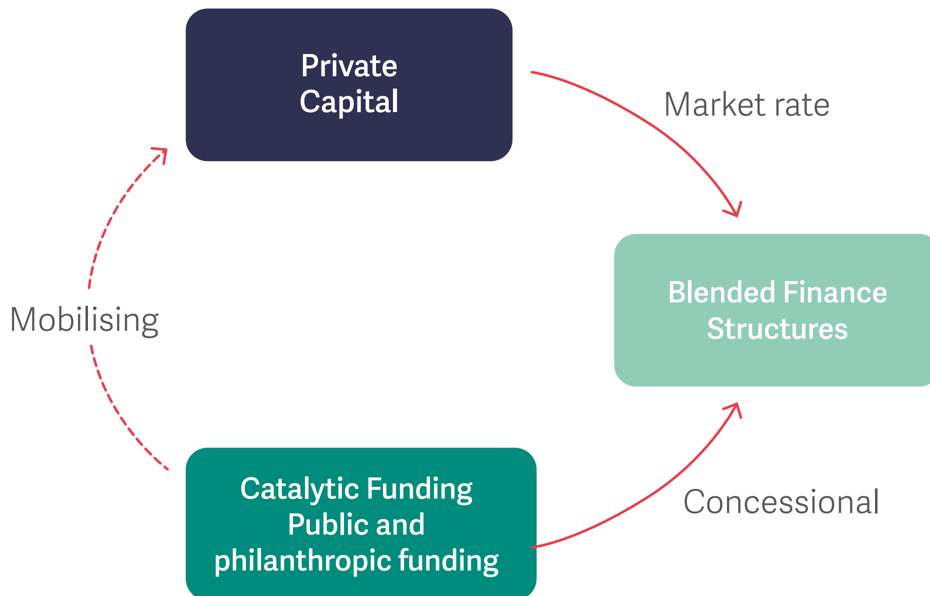
---

18 Fiduciary duty refers to the obligation of pension trustees (or other fiduciaries) to act in the best interests of the pension fund's members. In recent years, this has been generally interpreted as meaning the pursuit of the maximum financial return, regardless of other factors, such as economic, environmental or social outcomes. See: Impact Investing Institute, Impact investing by pension funds. Fiduciary duty – the legal context, October 2020.

Figure 1 illustrates the key elements of blended finance. Private capital in search of an investment return is combined with other, often more risk tolerant 'catalytic' funding that mobilises the former. Blended finance can be tailored to address specific investor risk/reward concerns, including return risk; credit; political or economic risks, and risks associated with untested and innovative business models. This, in turn, allows large, often mainstream, investors to increase exposure into less familiar opportunities, sectors or markets that present strong fundamentals but are associated with high perceived risk.

FIGURE 1: **Blended finance combines private capital in search of an investment return with other more risk tolerant 'catalytic' capital**

Blended finance structures



SOURCE: Adapted from Convergence, Blended Finance Primer.

Private capital can be provided by major institutional asset owners such as pension funds and insurers, as well as philanthropic funders such as charitable foundations. Investment managers may also be interested in incorporating blended finance structures into their investment offering. Catalytic funding providers supply risk-tolerant capital that can be used to fund instruments that encourage additional private sector funding. Such investors include public and government institutions (including national lotteries), philanthropic organisations (such as endowments and foundations), and Development Finance Institutions (DFIs), including multilateral development banks.

Other key actors in blended finance include social investors, who package financing for charities and social enterprises that often struggle to access affordable finance from mainstream banks. Intermediary organisations and consultants may also link investors and investees, providing knowledge and capability to advise on, structure and market/distribute investment propositions.

Transactions that incorporate blended finance span asset classes including private equity, private debt/illiquid credit and infrastructure. As shown in Table 1, a variety of established instruments are also being used to address the needs of different investors and incentivise greater participation. The

table covers both direct financing mechanisms and broader, enabling policy mechanisms such as tax credits.[19]

TABLE 1: **A variety of catalytic instruments are being incorporated in blended finance structures**

Category	Instruments	Commentary
Grants	Repayable and non-repayable grants	Uses include project/fund design and preparation and technical assistance, enabling projects to become commercially attractive, and early-stage R&D where there are positive externalities or risks investors cannot hedge.
Unfunded instruments/ contingent liabilities	Guarantees Insurance First Loss Facilities	Can be off-balance sheet for provider. Reduce tail risk for projects or portfolios, provide a floor on returns, or protect against a specific risk that the market cannot insure/hedge or misprices.
Co-investment	*Pari passu* equity or debt in sponsored funds and co-investment structures	A sponsor takes first-mover risk to create a portfolio because it has better information on investments and can monitor at lower cost/provide technical assistance. Crowds in investors as scale is created and risks are spread over a portfolio. Funds will often have different tiers for different risk/reward payoffs. Can include first-loss tranche and/or guarantees.
Concessional return funded structures and securities	Subordinated debt Subordinated equity Securitisation	Commonly priced at a concessionary rate. May be combined with a guarantee or first-loss facility to ensure that the overall risk/return profile attracts commercial investors. A junior tranche introduces loss absorption for commercial senior tranches.
Results-based incentives	Outcomes contracts Outcomes funds Development impact bonds	Provide incentives to achieve the desired outcomes or results, tying at least a portion of payments to achievement. The payments can go to both investors and service providers (and reduce the upfront capital required) assuming targets are met.
Broader enabling policy instruments	Tax credits Subsidies Risk reduction mechanisms e.g., price floors	Although not blended finance instruments per se, these policy instruments can help to crowd in commercial investors by changing the risk/return profile, or incentivising investment in areas where there are externalities or spillovers. Can provide markets for hedging risks where they do not currently exist.

20 The role of tax incentives for productive, sustainable investment is discussed elsewhere in the Economy 2030 Inquiry, see: P Brandily et al., Beyond Boosterism: Realigning the policy ecosystem to unleash private investment for sustainable growth, Resolution Foundation, June 2023.

As the case studies below show, many of these tools have the flexibility to be used individually or in combination, allowing variations in design, depending on the challenge they seek to address.

Context matters in determining whether to use blended finance

Blended finance is only one financial tool in a policy maker's arsenal, and the decision whether to deploy it is not always clear-cut. Governments will need to consider a number of factors before committing to using it to address a given policy need. Some investments are best delivered by the public sector alone; others left to the private sector. Decisions on whether to use blended finance and which instruments to employ will need to consider consider the outcome sought, the market failure to be addressed, the risks to be mitigated, and the additional considerations set out in Table 2.

TABLE 2: **Choosing blended finance instruments: factors to consider**

Factor	Key questions
Market failure	What market failure is being mitigated? (e.g. externalities, capital market imperfections, information frictions, market needs creating and/or desirable long-term policy priority not shared by market). Would the project or programme be funded if catalytic capital is not used?
Derisking	What risks are being mitigated? What tools – guarantees, first-loss tranches, insurance etc – would best address these?
Leverage	How can we create the greatest leverage (ratio of commercial capital to concessional capital/grants)?
Cost	How do we minimise concessionality or other costs to non-commercial funders?
Incentives	Which instrument will provide the optimal incentive structure to funders?
Sustainability	Will the overall structure be sustainable and able to raise commercial funding on an ongoing basis?

It is also necesaary to consider the degree to which the catalytic investor's priorities are shared with commercial or other desired investors. In some cases, the degree of concessionality which needs to be offered to attract commercial investors means a blended approach which targets them is inappropriate.

In the case of end-of-life care, for example, Social Finance has worked with the NHS, Big Society Capital, Macmillan and the Health Foundation on a series of successful outcomes contracts, but the priority has not been to deliver a market-rate financial return. The health sector in particular provides numerous examples of areas where it is neither feasible nor appropriate to use a blended finance approach with market return-seeking co-investors.

In other sectors, the time and financial cost of designing a structure that meets the needs of different investors with varying return expectations make the process unviable. A number of blended finance

initiatives in recent years in the environment space involving commercial banks as well as multilateral lenders have acted more as flagships for the art of the possible, rather than genuinely replicable instruments.

Such initiatives demonstrate the complexities and potential pitfalls that blended finance design must consider to achieve desired outcomes as well as value for money. Robust procurement considerations are vital to ensure that any instrument maintains its focus on delivering the required public policy outcomes – economic, environmental or social – and that returns do not accrue disproportionately to private investors. Social housing, for example, where funding has been substantially transferred from the public to the private sector, is widely regarded as not having delivered optimal outcomes for residents.[20]

Likewise, careful governance design is critical to ensure that power imbalances between investors do not dilute the focus on the desired policy outcome in favour of greater financial return. Governments will want to apply lessons learnt from previous blended finance initiatives, such as Private Finance Initiatives in the 1990s and 2000s. A 2011 report by the House of Commons Committee of Public Accounts found that PFI deals "look[ed] better value for the private sector than for the taxpayer", and listed a number of recommendations including more robust analysis by government, more accurate assumptions around tax, and better transparency of investor and contract information.[21]

The approach advocated in this paper is not for a new version of PFI, which risks creating financing structures which inappropriately shift public responsibilities off the public balance sheet, or deferring costs or liabilities for accounting ends. Rather we are setting out a range of approaches that can be tailored to the specific outcomes sought and the needs of the different investors involved. Financial, operational and delivery risk must be shared appropriately between public and private partners. Mistakes in the past, for example setting inappropriate price floors, should inform future project structures and design. Moreover, it is worth noting that taxpayer-funded catalytic capital does not have to be concessionary. Co-investment, where the government acts as anchor investor, can be as effective in mobilising private investment.

Critically, as set out in the next section, there is now a track record across asset classes that shows a blended finance approach can present substantial additional benefits that go well beyond funding. Bringing together the expertise and perspectives of both public and private funders can deeply enrich the project process, improving skills to encourage more use of non-government capital. Blended finance can devolve project decision-making to a more diverse, and often more local, group, potentially leading to better outcomes. Involving other funders also invites additional risk assessment.

Finally, blended finance can create a market for a public good, such as clean air, or renewable energy, where one does not already exist. As the Green Investment Bank (GIB) demonstrated in the case of wind energy, governments may ultimately be able to exit the financing arrangement, leaving behind a sustainable private funding model (see Box 2).[22]

---

20 The Housing Finance Corporation, Private finance in the social housing sector: how we got here, September 2022.
21 House of Commons Committee of Public Accounts, Lessons from PFI and other projects, July 2011.
22 S Matikainen, GIB going, going, gone! The future of the Green Investment Bank and sustainable investment in the UK, Grantham Research Institute, August 2017.

BOX 2: **The Green Investment Bank**

The Government created the GIB in 2012 to deliver investment needed to transition to a low carbon economy. From 2012 to 2017, the bank provided £3.4 billion in direct funding for projects in energy efficiency, waste and bioenergy, offshore wind, and onshore renewables.[23] As well as direct investment, the GIB mobilised private sector investment at a ratio of 1:3 – for every £1 the GIB invested, it mobilised another £3 in private capital. The GIB is widely credited with having created a functioning commercial market for offshore wind energy in the UK,[24] as well as making successful investments in other environmentally significant sectors.

In 2017, the UK Government sold the Green Investment Bank to a consortium led by Macquarie Group Limited for £2.3 billion. For many, the decision to sell at a very early stage of the GIB's existence represented a missed opportunity for future targeted investment where there was both significant need and the potential for the UK to be a global market leader.[25]

UK initiatives must also consider the international context. Other governments are pursuing blended finance initiatives as part of their broader industrial policies. The 2022 US Inflation Reduction Act (IRA) aims to direct $369 billion in federal funding to clean energy, to substantially lower the nation's carbon emissions by the end of this decade.[26] This investment is designed to be delivered using a range of financial and policy instruments, including grants, loan guarantees and tax credits.[27] Although it is too early to understand the impact of the IRA on the US economy, near-term indicators, such as announced investment projects and manufacturing and construction spending, point to an increase in private sector investment in related industries. Goldman Sachs estimates the IRA will unlock $3 trillion in private sector investments over the next decade.[28]

In the EU, the Green Deal commits over €1 trillion to transition EU countries to a sustainable economic model.[29] A key element of the Green Deal is the InvestEU programme, which aims to use guarantees from the EU budget to crowd in €372 billion in additional public and private investment.[30] A strong UK response to these international policy developments is needed to ensure that the UK is able to meet its net zero commitments and benefit from growth opportunities along the way, but this should be targeted and based on an understanding of the UK's unique strengths and circumstances.[31]

23 S Matikainen, GIB going, going, gone! The future of the Green Investment Bank and sustainable investment in the UK, Grantham Research Institute, August 2017.
24 Macquarie Green Investment Group, World's first offshore wind fund manager powers through £1bn target, January 2017.
25 For a full profile of the Green Investment Bank, please see: S Gordon, Investing in our future: practical solutions for the UK government to mobilise private investment for economic, environmental and social policy priorities, Grantham Research Institute, October 2023.
26 Indeed, given that much of the support is uncapped, the total amount could be significantly higher than this. See: J Bistline et al., Economic Implications of the Climate provisions of the Inflation Reduction Act, NBER Working Paper Number 31267, May 2023; and REPEAT-Rapid Energy Policy Evaluation and Analysis Toolkit, Preliminary report: The climate and energy impacts of the Inflation Reduction Act of 2022, August 2022.
27 McKinsey & Company, The Inflation Reduction Act: Here's what's in it, October 2022.
28 See: H Boushey, The Economics of Public Investment Crowding In Private Investment, The White House, August 2023.
29 European Commission, A European Green Deal.
30 European Union, InvestEU programme.
31 For further discussion, see: P Brandily et al, Beyond Boosterism: Realigning the policy ecosystem to unleash private investment for sustainable growth, Resolution Foundation, June 2023.

Existing UK examples provide lessons for scaling up blended finance approaches

Blended finance has mobilised approximately $200 billion to date in developing countries,[32] but there are no current estimates of its use in the UK. The British Business Bank used blended finance approaches in the Future Fund to support UK businesses during the pandemic,[33] and the UK Infrastructure Bank has a target of deploying £2.5 billion in guarantees a year. But such activities are at a small scale relative to the country's investment needs.[34]

There are a number of existing UK examples, though, which provide models to achieve desirable economic, social or environmental impact, which could now be replicated at scale. This section sets out four case studies that demonstrate blended finance's effectiveness in supporting projects that can deliver net zero objectives, build sectors that are strategically important for the UK, or improve opportunities for disadvantaged groups.

Case study 1: Mayor of London's Energy Efficiency Fund

London aims to be a net zero carbon city by 2030, but historic financing of its low-carbon infrastructure has been fragmented and nowhere near the scale required to achieve this target. Catalytic public funding is required to address both challenges by providing flexible and competitively priced finance for low-carbon projects across the capital.[35] The Mayor of London's Energy Efficiency Fund (MEEF) is a £500 million+ investment fund, established in 2018 by the Greater London Authority with European Commission funding and managed by Amber Infrastructure Group (see Figure 2).

To cater to different investor risk appetites, MEEF comprises both senior (low-risk) and junior (high-risk) debt tranches. The public funds provided by GLA/EU principally fund the latter and accept the potential capital risks of market failure, enabling private investors including commercial banks, and other fund investors, to allocate to the lower-risk senior debt. The GLA has committed £101.4 million, which in turn has enabled Amber Infrastructure Limited to secure £456 million from private investors – close to five times the public funding.

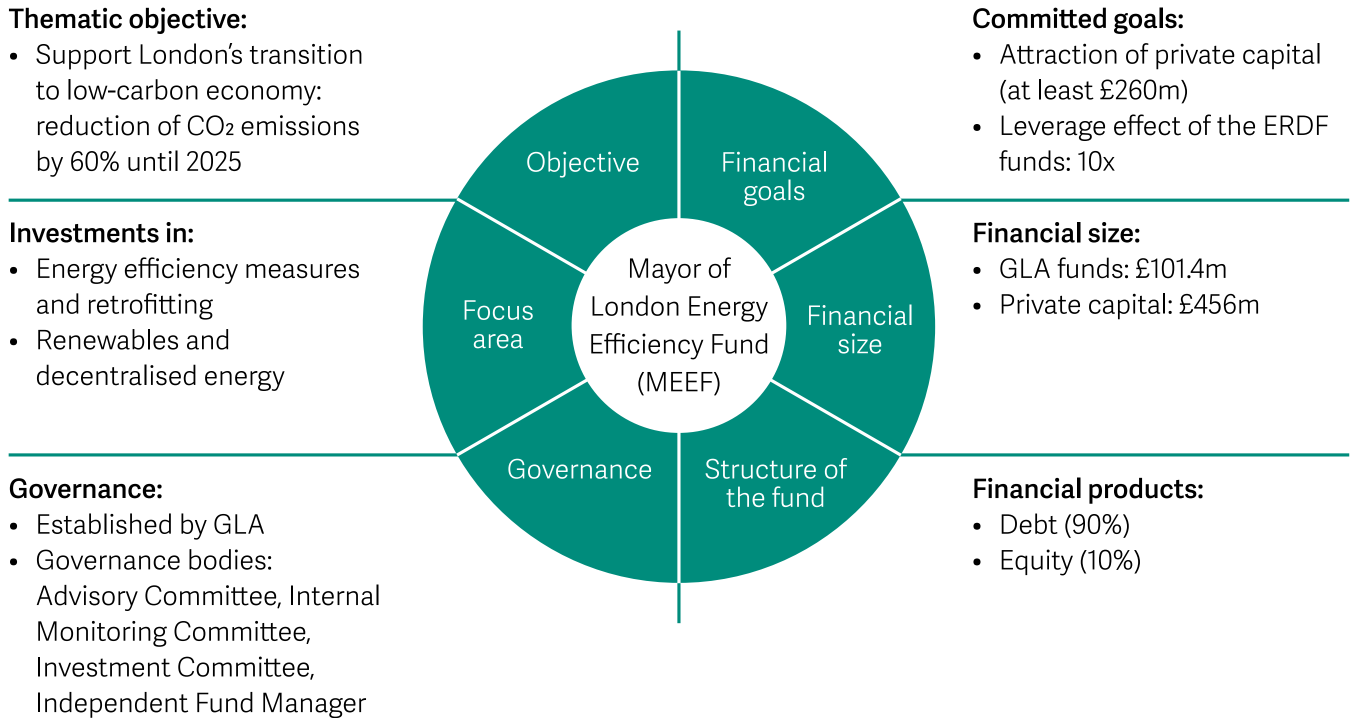
MEEF has invested in small and-medium-sized enterprises (SMEs), and NHS and Local Authority projects across London. These include innovative projects such as electric vehicle charging infrastructure combined with energy storage, and an energy performance contract with guaranteed savings for the NHS.[36]

---

32 Convergence, Blended Finance Primer. Web page, not dated.
33 British Business Bank, Future Fund scheme overview
34 It is worth noting that there is no data available on the total amount of blended finance deployed in the UK, nor evaluation of its impact.
35 Net zero investment is subject to a wide range of market failures which extend over and above the greenhouse gas externality to include higher financing constraints, information frictions, the lack of a market for some of the co-benefits such as clean air (for further discussion, see N Stern & A Valero, Innovation, growth and the transition to net-zero emissions, Research Policy 50 (9), November 2021).
36 As at the beginning of September 2023, see: https://www.amberinfrastructure.com/our-funds/the-mayor-of-londons-energy-efficiency-fund/.

FIGURE 2: **The Mayor of London Energy Efficiency Fund addresses the capital risks of low-carbon projects in order to attract private capital**

Key elements of the Mayor of London Energy Efficiency Fund



SOURCE: European Investment Bank, Multi-Region Assistance Project-Revolving Investment for Cities in Europe (MRA-RICE), Case Study - London, September 2018; and MEEF. Updated Amber Infrastructure, September 2023

Case study 2: Arts & Culture Impact Fund LLP

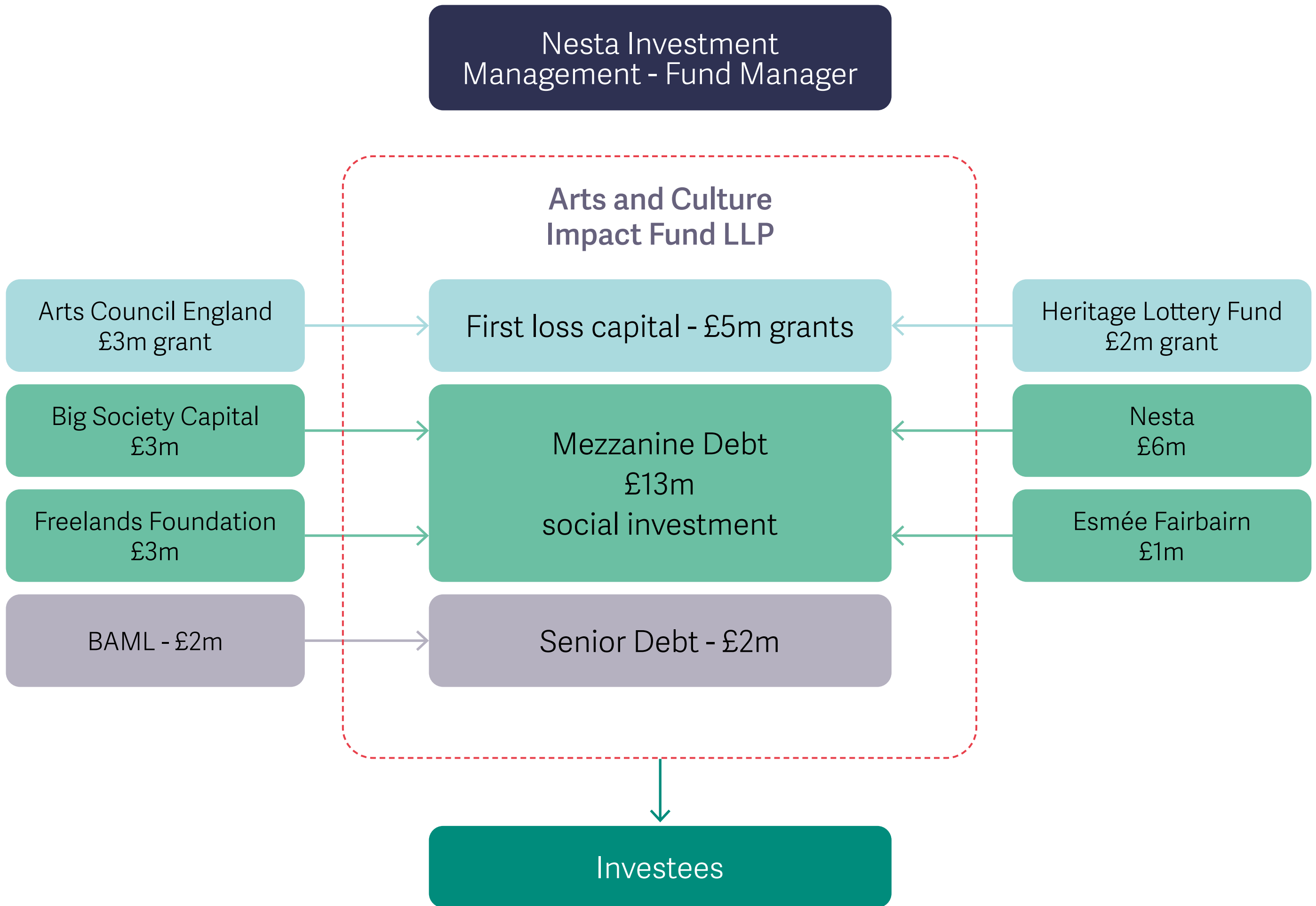
The Economy 2030 Inquiry has highlighted that the UK's strengths as a services exporter span a range of high-value tradable services, including cultural ones.[37] Arts and culture also generate wider social benefits for communities.[38] However, the sector has been under financial pressure in the aftermath of Covid-19 and cuts in public funding.[39] A growing scarcity of grants means that arts and culture social enterprises increasingly need to consider repayable finance to fund their activities, but these enterprises find it difficult to access affordable lending.

Arts & Culture Finance, a division of innovation agency Nesta, launched the Arts & Culture Impact Fund in March 2020, to provide arts, culture and heritage organisations with affordable, flexible and unsecured loans, repayable by 2030 (see Figure 3). The Fund's investors include public, private and philanthropic funders, including Arts Council England, Big Society Capital, Bank of America, and the Esmée Fairbairn Foundation.

37 J De Lyon et al., Enduring Strengths: Analysing the UK's current and potential economic strengths, and what they mean for its economic strategy at the start of the decisive decade, Resolution Foundation, April 2022.
38 Participation in arts and culture can be linked with reduced stress and anxiety, for example. See a range of evidence: https://whatworkswellbeing.org/category/culture-arts-and-sport/.
39 Investment in the arts through Local Authorities in capital and revenue expenditure in the arts in England has fallen by more than 30 per cent in real terms between 2009-10 and 2019-20 in response to an overall decline in local government budgets over this period. See: E Easton & S Di Novo, A new deal for Arts funding in England?, Creative Industries Policy and Evidence Centre, January 2023.

FIGURE 3: **Fund designed for different investors' risk and return appetites**

Investors' contribution to tiered structure



SOURCE: Big Society Capital and Nesta

To encourage investors to support unsecured lending to this largely untested sector, the £20 million Fund has a three-tranche structure to tailor levels of reward and risk:

- First, a concessional, first-loss tranche of £5 million in repayable grants;
- Second, a mezzanine layer of £13 million provided by social investors, which pays a return that was attractive at launch to reflect its risk profile;
- And finally, a senior debt layer of £2 million, which is marketed to private investors – its lower rate of return reflects its low credit risk, making it attractive to risk-sensitive debt investors.[40]

Case study 3: Growth Impact Fund

The economic and social impact of Covid-19 and the subsequent cost-of-living crisis have highlighted structural inequalities across the UK.[41] Large-scale funding is needed to address the exclusionary barriers marginalised communities face and increase their access to opportunity. Lowering these

40 It should be noted that the fund launched in a low interest-rate environment, where 1 per cent provided an attractive return.
41 See, for example, A Eyles, Social mobility in the time of Covid, Resolution Foundation, December 2021; M Brewer, E Fry & L Try, The Living Standards Outlook 2023, Resolution Foundation, January 2023.

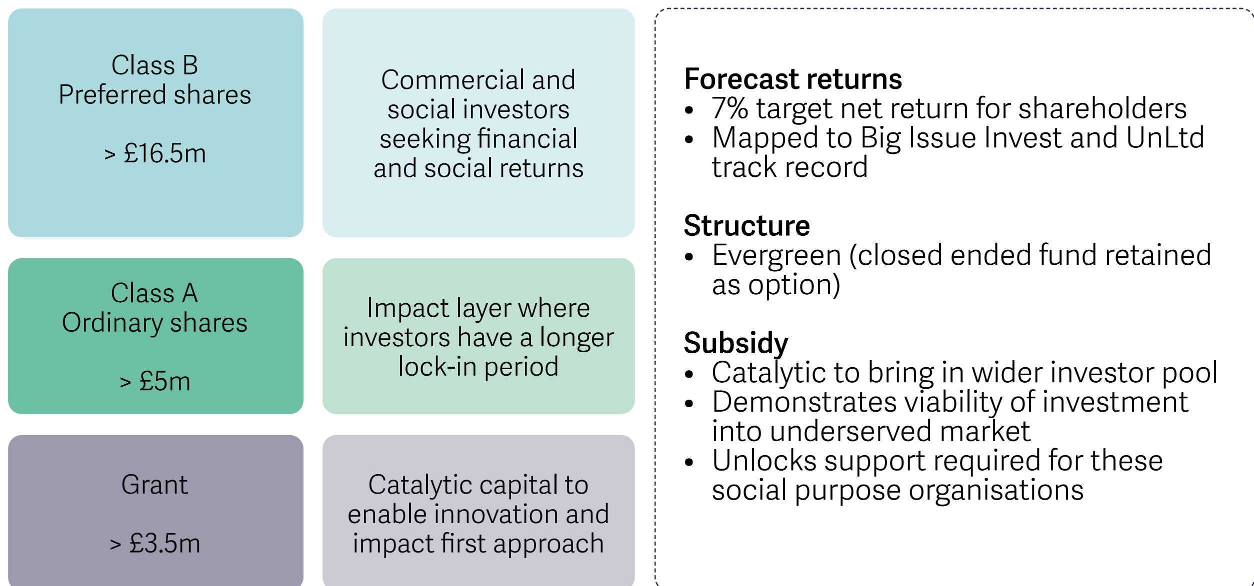
barriers is not a goal widely shared by commercial investors, but public funding to do so is limited. Attracting a mixture of concessional investors and commercial investors with both an impact and financial return goal provides a way to fill this gap.

The Growth Impact Fund is a blended capital fund launched in 2022 by social investment specialists Big Issue Invest Fund Management, UnLtd, and Shift. It has a target size of £25 million, and an initial five-year investment period, providing patient and flexible capital to social purpose organisations (SPOs), which combine sustainable business models, job creation and a focus on social justice.

At least 50 per cent of the fund's investments are to be made to diverse-led SPOs, 70 per cent of the fund's capital will be deployed into equity or quasi-equity investment products, and the other 30 per cent will provide patient and affordable debt products. The fund has a three-tiered structure, as shown in Figure 4. Both investment layers have a target 7 per cent net return, but the social investment tranche has a longer lock-up period. These returns are supported by the £3.5 million grant layer, which subsidises upside returns and provides downside protection for investors.

Grant funding is provided by Access, the foundation for social investment, and Bank of America Foundation. Philanthropic funders can also participate through grants in the catalytic capital layer and in the technical assistance facility.

FIGURE 4: **The Growth Impact Fund - offering competitive returns and significant impact through a tiered structure**
Growth Impact Fund structure



SOURCE: UnLtd

Case study 4: Schroder BSC Social Impact Trust plc

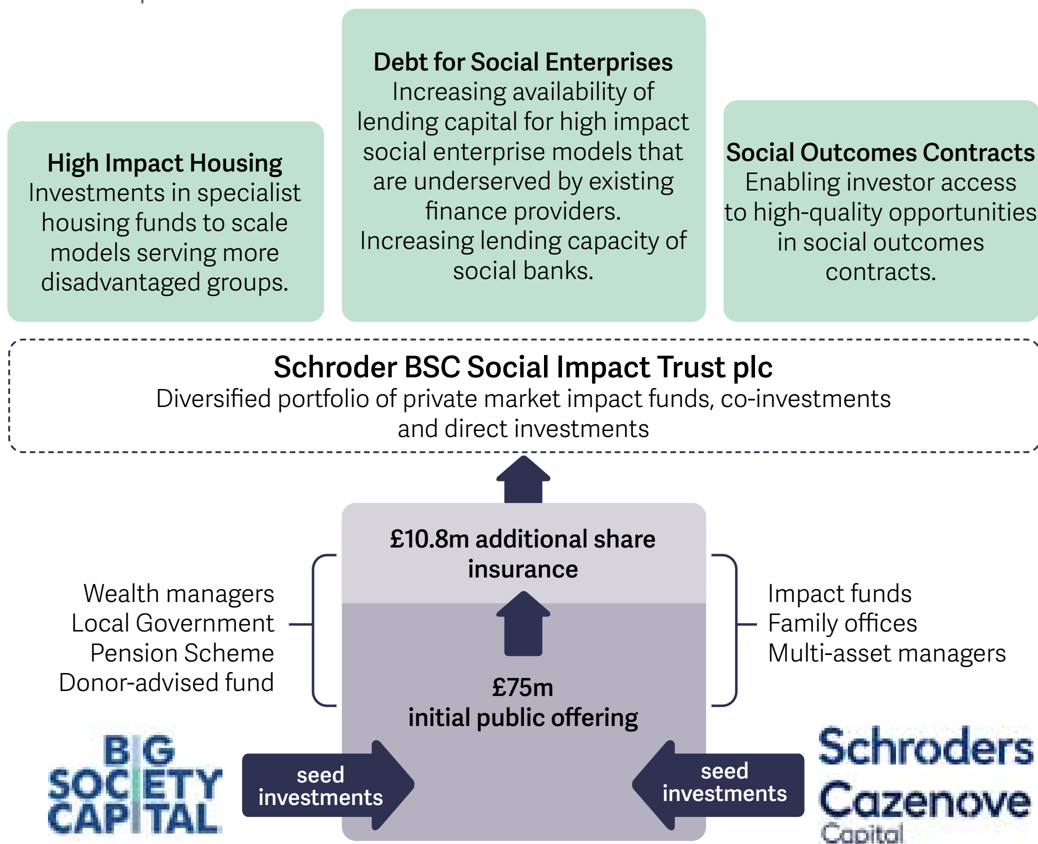
Research shows that 81 per cent of adults would like their investments to do some good as well as provide a financial return.[42] But accessing private markets, where social impact is often most effectively delivered, can be difficult for retail investors, given high minimum investment requirements, long ramp-up periods, concentration risk and limited expertise.

The Schroder BSC Social Impact Trust was listed in December 2020 to address this market failure, providing a liquid vehicle for wealth managers, advisers and their clients to participate in private impact markets (see Figure 5). It invests in a diversified portfolio of private market impact funds, co-investments and direct investments, focusing on supporting social enterprises, high-impact housing and social outcomes contracts across the UK. The fund's publicly-traded structure ensures daily liquidity for investors.

To catalyse the initial public offering (IPO), social investor Big Society Capital provided a seed portfolio of investments alongside investment from Schroders and its wealth management arm, Cazenove Capital. This enabled the trust to raise £75 million from its IPO in December 2020. In November 2021, it raised a further £10.8 million through a share issuance to investors.

FIGURE 5: **Schroder BSC Social Impact Trust plc uses a tranched structure to tailor risk and reward**

Schroder BSC Social impact Trust structure



SOURCE: Big Society Capital

42 Financial Conduct Authority, Sustainability Disclosure Requirements (SDR) and investment labels, consultation paper, October 2022

Taken together, these case studies demonstrate that, deployed well, blended finance allows budget-constrained organisations to crowd in multiples of private investment to address pressing economic, environmental and social challenges. But they also highlight some important guidance for policy-makers or institutions seeking to replicate blended finance vehicles at greater scale:

- It is important for different investors to work together from the outset to identify the most appropriate investment funding structure and design.
- The design of the investment vehicle is most effective when driven by clear identification of the desired outcomes at the initial stages.
- A collaborative approach is critical to designing the optimal funding vehicle, and increasing each partner's understanding of other stakeholders' priorities. Such an approach has positive knock-on effects for future projects and, potentially, improves ways of working at each partner, as a result of sharing best practice and alternative methods of addressing a given policy challenge.
- Investment vehicles should be tailored to the different financial return and impact expectations of investors – whether government, grant providers, social investors, or investors seeking a commercial return.
- Outcomes contracts, with payment for successful achievement of agreed outcomes, are one of the best ways for governments to ensure value for money from blended finance structures.
- Measurement of, and accountability for, outcomes as well as financial performance is key as it establishes credibility for future rounds of fundraising.

We have set out how blended finance deals require thoughtful structuring and trust between partners. However, current capacity in the country to intermediate these sorts of deals is scarce. Skill-building at government departments and local authorities, as well as at mainstream financial institutions unfamiliar with this approach, will be needed to roll out blended finance solutions at scale across the UK. This is addressed in the recommendations in the next section.

Six enablers could help achieve a significantly more ambitious deployment of private investment towards public policy priorities

There is a significant opportunity for governments and government-backed institutions – such as the British Business Bank, the UK Infrastructure Bank and, in the sphere of development finance, British International Investment – to deploy the instruments described in the case studies above to crowd in private sector capital at far greater scale than is currently happening.

Rolling out these solutions at scale would be greatly facilitated by adopting six regulatory or policy 'enablers'. These measures have been formulated following extensive discussion with policymakers, regulators, social investors and financial services industry representatives, and seek to create structures and approaches that are attractive to all stakeholders.

Each enabler could be implemented in isolation. However, implemented together, these six actions would provide a powerful set of tools to achieve ambitious deployment of private investment for public policy priorities.

Enabler 1: UK Growth Fund

A new UK Growth Fund, managed by the British Business Bank or UK Infrastructure Bank and overseen by HM Treasury (see specifics on institutional arrangements below), could attract long-term capital from major institutional investors into key growth sectors (start-up and beyond).

A key objective would be to mobilise pension and insurance assets, which total £4.6 trillion in the UK. In this way, this proposal builds on the range of recent proposals for some type of economic growth-focused 'super-fund', mobilising pension savings pools in particular and boosting the role of government-backed institutions such as the British Business Bank (as discussed elsewhere in the Economy 2030 Inquiry)[43]. We outline these others organisations' proposals in Appendix 1. Our calculations suggest the UK Growth Fund could have an investment target of £5 billion at launch, rising to at least £50 billion over five to 10 years.[44] As well as providing a vehicle for long-term invetsment in the UK, the UK Growth Fund would address other challenges to the country's future prosperity, including: the large number of innovative UK companies sold to non-UK buyers, with future value creation shifting overseas as a result; the declining number of private companies seeking a public listing in the UK;[45] and the inadequacy (or non-existence) of markets in key sectors of the UK's economy, particularly in climate solutions.

The UK Growth Fund would comprise two elements. First, a diversified venture capital fund-of-funds would provide a superstructure to attract investment from mainstream investors such as pension funds. Second, the fund-of-funds would house a set of sector-specific blended finance funds, each designed to address a market failure or funding gap within specific sectors of focus, as decided by the Government. The case studies outlined above give examples of what these might look like. These sector-specific funds would be designed for investors into young and start-up private companies, potentially attracting £10 billion of venture capital financing in addition to the investment in the umbrella fund-of-funds, catalysed by government seed funding.[46] Meanwhile, investors in the umbrella fund-of-funds would receive a diversified portfolio of shares or units in each of the sector-specific funds. These sector-specific funds could be modelled on the Green Finance Institute's Battery Investment Facility (see Box 3).[47]

---

43 See: P Brandily et al., Beyond Boosterism: Realigning the policy ecosystem to unleash private investment for sustainable growth, Resolution Foundation, June 2023. Proposals are set out to enable consolidation across the pensions landscape, allowing for more investment in productive assets including unlisted firms, as well as more engaged ownership (as blockholders) in UK listed firms. The Chancellor Jeremy Hunt's Mansion House Reforms, announced in July 2023, seek to channel pension savings into unlisted firms with a number of initiatives; see: HM Treasury, Mansion House 2023, July 2023.

44 In its Levelling Up white paper, the UK government set out its ambition for Local Government Pension Scheme funds to invest up to 5 per cent of their assets in projects which supported local areas. This would direct £18.45 billion (5 percent of LGPS 2022 assets of £369 billion) into UK-based productive investment opportunities. The government is now consulting on these proposals with LGPS and the pensions industry. Building on these proposals, the (conservative) calculations for initial investment into the UK Growth Fund assume a >0.1 per cent asset allocation from the existing £4.6 trillion in UK pensions and insurance assets, which includes the LGPS, building to >1 per cent over 5-10 years. See: DLUHC, Levelling Up the United Kingdom, February 2022,

45 Since 2000, the share of the UK stock market owned by UK pensions and insurance companies has fallen from 39 per cent to 4 per cent, and just 1 per cent of these assets is invested in unlisted UK companies. See: W Wright, Unlocking the capital in capital markets, New Financial, March 2023.

46 Recent funding rounds of private market vehicles in the UK demonstrate that there is huge demand from non-UK as well as UK investors for these types of opportunities, particularly in climate technologies. This estimate is based on confidential discussions with private market investors about the scale of appetite for potential vehicles of this kind. The size and structure of each sector-specific fund will vary depending on need and investor appetite, but assuming that each fund aims for £500 million investment at launch, rising to £1 billion between years 1-5, 10 such funds would attract £10 billion of VC funding.

47 Green Finance Institute, Powering the Drive to Net Zero: Unlocking Public and Private Capital for the UK Battery Sector, May 2022

The blend of public and private capital, whether to use debt or equity, and the use of catalytic capital options, could vary between the funds depending on sector and need. Both the UK Infrastructure Bank and the British Business Bank have the potential to provide this type of support, which will be identified during the design phase of each fund. Support could take the form of seed funding, first-loss capital, guarantees or pari passu co-investment, dependent on the outcome of the design consultation.[48] The sector-specific funds would be managed by individual asset managers, selected through a competitive tender process.

A well-designed route to exit would encourage constituent private companies either to be sold to trade buyers or to go public on a UK stock exchange. If portfplio companies were sold to a non-UK buyer or listed abroad, an 'exit penalty' to HM Treasury could be payable, . Sector-specific funds could also potentially cease to exist once a sustainable market had been established.

The fund-of-funds would also need to be designed through collaboration between investors and Government. It should be noted that mandating private investment, such as Defined Contribution pension funds, into a government-controlled vehicle is likely to discourage private investors from engaging positively with the initiative.

BOX 3: **Green Finance Institute's Battery Investment Facility**

The Green Finance Institute (GFI) has been working to bridge the financing gap in the nascent UK electric vehicle (EV) battery sector.[49] The sector presents a significant growth opportunity, with the UK automotive supply chain for EV technologies forecast to be worth £24 billion a year by 2025. Through engagement with finance, industry and the Government, the GFI designed a blended finance de-risking facility – a Battery Investment Facility – to crowd in private capital and widen the pool of investors in the sector.

To assess appetite for the facility, the GFI and its Coalition for the Decarbonisation of Road Transport[50] consulted with the private investment sector, representing about £1.8 trillion in assets under management. There was strong support for an equity/debt blended finance de-risking facility and an independent fund manager to ensure efficient and speedy deployment of funds. It also identified a pipeline of investment-ready projects waiting for finance.

Enabler 2: UK Community Growth Fund

The UK Growth Fund proposed above would direct funding to new and fast-growing areas of the UK economy. But a separate vehicle is also needed to take advantage of the opportunities to finance businesses and communities that struggle to access mainstream finance, primarily through Community Development Finance Institutions (CDFIs). Blended finance vehicles have already successfully increased the flow of capital, both public and private, to CDFIs in the UK. Mobilising

48 Both UKIB and the BBB have an explicit mandate to crowd in private capital. UKIB aims to deploy up to £3 billion of debt and equity and £2.5 billion of guarantees a year, committing £22 billion over the next five to eight years, subject to the pipeline of investable projects in each year. It can provide both corporate and project finance and invest across the capital structure, including senior debt, mezzanine, guarantees and equity. See: UK Infrastructure Bank, 2022 strategic plan.
49 Green Finance Institute, Battery Investment Facility (BIF)
50 Green Finance Institute, Coalition for the Decarbonisation of Road Transport

more private-sector capital would deliver a step-change in their capacity and capability to lend to marginalised communities, as well as increasing their agency, and the democratic accountability of public investment, particularly in the regions and devolved nations.[51]

There are currently 35 enterprise-lending CDFIs across the UK, which collectively lent £248 million in 2022. Their lending disproportionately goes to the UK's most deprived areas, and to female- and BAME-led enterprises.[52]

The sector has yet to receive major investment by large commercial players – but the interest is there, as is the appetite from the CDFIs themselves to take on the finance. This is evidenced by the Community Investment Enterprise Facility, launched in 2018, and the planned launch of an expanded version of this in autumn 2023, involving private and public investors.[53] Building on this example, the Impact Investing Institute and Social Finance are working on a blended finance CDFI investment vehicle prototype, combining commercial and non-commercial capital at scale. This could provide a model for a government-led UK Community Growth Fund, which would target £100 million of commercial and social investment at launch, growing as additional investors take part.

The US also provides useful lessons for a UK Community Growth Fund, through its legislative and financial support for CDFIs, and its Community Development Financial Institutions Fund,[54] established in 1994 as a bipartisan initiative to promote economic revitalisation and community development through investment in and assistance to CDFIs.[55]

Enabler 3: Government blended finance unit

To fully realise the potential to increase flows of private investment into public policy priorities, coordinated commitment, oversight and expertise is needed within central government. This should include establishing a new unit within HM Treasury, and involving other government departments to drive it forward.

The new unit would have five responsibilities:

1. It would coordinate and drive efforts to mobilise more private sector capital at scale within central budgetary processes and across government, including the Cabinet Office and the departments for business, education, energy, health, levelling up and communities, transport, and work and pensions.
2. It would provide a centre of expertise and knowledge-building on blended finance, with a focus on skill-building across government and local authorities.
3. It would host a stakeholder advisory group, made up of senior civil servants and financial services representatives, to ensure effective collaboration across the investment spectrum.

---

51 It is worth noting that there is a separate consultation ongoing by DCMS and DLUHC on the creation of a Community Wealth Fund for social enterprises and charities. See: Department for Culture, Media and Sport and Department for Levelling Up, Housing and Communities, Technical Consultation on a Community Wealth Fund in the UK, September 2023.
52 Responsible Finance, Impact Report 2023.
53 CIEF is a £60m investment facility, seeded by £30m from Big Society Capital with £30m in matched funding from Triodos Bank and Unity Trust Bank, and managed by Social Investment Scotland Social Investment. See: Social Investment Scotland, Community Investment Enterprise Facility (CIEF).
54 US Treasury Department, Community Development Financial Institutions Fund, Overview
55 Metro Dynamics and the Impact Investing Institute, Building Strong Places: a new, impactful role for financial institutions, November 2021.

4. It would oversee both the UK Growth Fund and the UK Community Growth Fund, in coordination with the UK institutions selected for their management.
5. Finally, it would be responsible for evaluating the impact of blended finance initiatives across government, including the UK Growth Fund and the UK Community Growth Fund, ensuring that evaluation focuses not just on "value for money" but "impact for money" achieved.

Enabler 4: New guidance on fiduciary duty

Institutional investors such as pension funds are a major source of private capital. But current guidance on and interpretations of fiduciary duty discourage pension fund trustees and other fiduciaries from allocating to investments that deliver a positive economic, environmental or social outcome as well as a financial return. To direct greater flows of private investment to public policy priorities, new guidance on fiduciary duty is urgently required from the Department for Work and Pensions and, in the case of the Local Government Pension Scheme, the Department for Levelling Up, Housing and Communities. At a minimum, this guidance should reassure trustees that they are within their duties when taking economic, environmental or social considerations into account in their investment choices, in the context of an overall investment strategy which aims to deliver market-adjusted returns. This would increase capital flows into the UK Growth Fund and other productive assets. Guidance could draw on work by the Impact Investing Institute,[56] the 2022 High Court judgement which ruled on charity trustees' legal duties,[57] and ongoing work by the Financial Markets Law Committee.[58]

Enabler 5: Investment incentives and penalties

The proposed UK Growth Fund and its underlying sector-specific funds will be designed to be attractive to all types of institutional investor, from mainstream pension funds to specialist angel investors. As such, additional incentives should not be necessary. However, the Government might want to consider a set of tax or investment incentives, to overcome investors' initial unfamiliarity with the new UK Growth Fund, and thus uncertainty about allocating to it. These incentives could be reviewed at the end of three or five years.

Investment incentives would complement the new guidance on trustees' fiduciary duty, providing a compelling basis for a range of institutional investors to allocate to the UK Growth Fund. Venture capital and other private equity investors into the sector-specific funds could be offered an incentive modelled on the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS).

Portfolio companies that are ultimately sold or which list outside the UK would reimburse the taxpayer incentives from which they have benefited. If companies instead exit via purchase by a UK trade buyer or listing on a UK stock exchange, this penalty would not apply, as detailed in Enabler 1 above. All investment incentives and penalties, therefore, would also help to retain intellectual property, promote jobs and skills in the UK, and encourage a flow of public listings on UK exchanges.

56 Impact Investing Institute, Pensions: Providing practical guidance to make impact an investment priority.
57 Association of Charitable Foundations, The Butler-Sloss case – what does it mean for decisions on investment?, June 2022.
58 Financial Markets Law Committee, Joint Meeting of the ESG and Insurance & Pensions Scoping Forums, May 2022.

More generally, and in order to improve the overall investment ecosystem in the UK, the Economy 2030 Inquiry has made proposals to improve the incentives for public and private sector investment. In particular, it proposes rewiring Treasury incentives around public sector investment by setting fiscal objectives that explicitly treat investment spending differently from current spending.[59] And it has proposed tax and other reforms to incentivise business investment.[60] As discussed previously, the UK's response to the US Inflation Reduction Act should consider where there is scope for enhancing tax incentives for net zero investments in fixed capital or innovation. These measures would complement the proposals we have outlined here.

Enabler 6: Government institutional mandates and incentives

Managing the proposed UK Growth Fund, its sector funds, and the UK Community Growth Fund requires strengthening the mandates and incentives at UK national finance institutions backed by Government, such as UKIB or the BBB, for mobilising private sector capital. All too often, this role is deprioritised against other objectives, such as delivering a targeted return on investment, growing the institution's own balance sheet, or 'shifting product' (the perceived goal of getting a significant number of deals done). As a result, there are many missed opportunities for designing government-backed investment vehicles that crowd in private capital. A recent example is the launch by the BBB of the £200 million South West Investment Fund,[61] which provides loans from £25,000 to £2 million and equity investment up to £5 million, but has no focus on mobilising private investment alongside its own commitments.

To enable the UK's economic development institutions to fulfil their potential for crowding in private investment (both return-seeking and philanthropic), the incentives and rewards need to be clearer and more powerful. In particular, private capital mobilisation should be made an objective of equal weight as balance sheet investment, and reflected in the remuneration of key executives.

Conclusion

This paper has proposed a set of collaborative actions that could transform the way private and public investors work together to deliver productive investment that is consistent with greater social equality and environmental sustainability. The good news – as this paper has shown – is that multiple successful examples of such public-private collaboration already exist in and outside the UK. Blended finance provides a critical and powerful tool that can be deployed at far greater scale and for far greater benefit than has been the case to date. Replicating the successful – yet so far relatively small-scale – examples of blended finance investment vehicles in energy, education, health, housing and other sectors would have the potential to mobilise far greater flows of private capital. Establishing two national funds would deliver more effective investment into priority sectors and communities across the UK. And removing barriers and enhancing incentives would enable private investors to work more effectively with government for public policy priorities.

Blended finance investments are most effective when driven by clear identification of the desired outcomes, strengths and limitations of all parties at the initial stages. Measurement of and

59 F Odamtten & J Smith, Cutting the Cuts: How the public sector can play its part in ending the UK's low-investment rut, Resolution Foundation, March 2023
60 P Brandily et al., Beyond Boosterism: Realigning the policy ecosystem to unleash private investment for sustainable growth, Resolution Foundation, June 2023.
61 British Business Bank, South West Investment Fund (SWIF)

accountability for outcomes is as critical as financial performance in delivering the required policy goals. This is one of the many lessons from past experiments with public-private partnerships which the government would want to build into future initiatives.

Implemented together with a broader package of reforms to improve the business investment ecosystem in the UK (as set out by the Economy 2030 Inquiry), including institutional reforms to help reduce uncertainty, our proposals would enable the UK Government to work more effectively with private investors to create economic, environmental and social change at scale and at pace.

Appendix 1 – Proposals for an economic growth 'superfund'

Existing proposals

There are a number of existing proposals for a new growth fund in the UK, many centred on reform of the country's pensions regime. All suggest that there is building momentum for large-scale and radical action, and this paper's proposals seek to build on this in practical ways.

An earlier report by the Economy 2030 Inquiry proposes that the Government should legislate to expand the remit of the Pension Protection Fund to allow it to act as a state consolidation option for solvent pension schemes, giving trustees who want the certainty associated with buy-outs an alternative route. These reforms would create several large Defined Benefit funds with both the incentives and capabilities to invest actively in UK equities.[62] It also proposes the pooling of Local Government Pension Scheme funds into one consolidated fund. The same paper recommends that the British Business Bank should be allowed to borrow capital through the issuance of government-guaranteed bonds in the same way that Germany's national development bank, KfW, is able to, and that the BBB offer a co-investment fund which would allow pension funds to invest as a limited partner alongside it, piggybacking on its expertise. Elements of these proposals have also been recommended by the Tony Blair Institute for Global Change.[63]

The Institute for Public Policy Research IPPR proposes establishing a national investment fund to provide equity and equity-like (convertible loans) financing to companies willing to expand production in green manufacturing activities and to decarbonise heavy industry processes.[64] The fund would be a 'holding organisation' with minority stakes in a broad range of companies. The IPPR also proposes transferring the 4,500 smallest DB funds into a pensions 'superfund' managed by the Pension Protection Fund. In tandem, it recommends establishing a series of regional, return-generating, not-for-profit entities that would progressively absorb the UK's 27,000 Defined Contribution funds, the LGPS, the remaining DB funds and, potentially, other non-LGPS public-sector pension schemes, which in most cases are not funded. The end goal would be to establish around six £300-£400 billion long-time-horizon diversified funds, which, it argues, would generate better, and more secure returns for pensions than the 5,200 existing DB funds.

Forthcoming proposals from the Capital Markets Industry Taskforce are expected to address the need to consolidate both Defined Contribution and Defined Benefit pensions into pools with greater investment clout,[65] and the current Lord Mayor has published a proposal to establish a growth fund specifically for consolidated DC pension capital and led by the private sector to invest in UK tech companies.[66]

The Chancellor's Mansion House speech announced an agreement between nine of the UK's largest Defined Contribution pension providers, committing them to the objective of allocating 5 per cent of the assets in their default funds to unlisted equities by 2030. These providers represent over £400 billion in assets and the majority of the UK's Defined Contribution workplace pensions market. The Government argues that this could unlock up to £50 billion of investment in high growth companies

62 P Brandily et al., Beyond Boosterism, Resolution Foundation, June 2023.
63 J Kakkad, M Madsen, M Tory, Tony Blair Institute for Global Change, Investing in the Future: Boosting Savings and Prosperity for the UK, 29 March 2023
64 S Gasperin, G Dibb, IPPR, Growing Green: A proposal for a national investment fund, 23 August 2023
65 Capital Markets Industry Taskforce
66 City of London Corporation, Powerful Pensions: unlocking DC capital for UK tech growth, 21 August 2023

by 2030 if all UK DC pension schemes followed suit. The Chancellor has also asked the British Business Bank to explore the case for government to play a greater role in establishing investment vehicles. The speech proposed consolidation of both the DC and DB pension pools, with a target for LGPS funds of a minimum fund size of £50 billion in assets and a target of investing 10 per cent of their assets in private equity.[67]

The Labour Party has proposed providing catalytic public investment through a Green Prosperity Plan, to crowd in private sector investment to the industries of the future. It would reform the British Business Bank, unlocking institutional investment so that more patient capital is available to new and growing businesses,[68] and would establish a National Wealth Fund.

How does the UK Growth Fund differ from existing proposals?

The UK Growth Fund proposed in this paper builds on many of these innovative ideas, particularly the IPPR's proposal for a national investment fund, but it differs in a few key features and, critically, its structure is designed to appeal to a broad range of private investors with different mandates, investment approaches and risk tolerance. Mainstream institutional investors such as pension funds will be encouraged to invest in the fund-of-funds 'umbrella', whilst venture capital investors will invest in the underlying sector-specific funds.

The UK Growth Fund is designed to work within the UK government's existing processes and institutions. It does not involve mandating investors, including pension funds, to shift their assets or strategies. Mandation will discourage private investors from co-operating in the establishment of any such fund, and is in direct contradiction to 'best practice' in designing blended finance vehicles.

The approach advocated in this paper is for collaboration between public and private investors, and for any blended finance fund to be co-created and designed from the outset in a collaborative process, designed to take advantage of the different expertise of respective sectors. This is one of the most important lessons learnt from successful blended finance initiatives in the UK and elsewhere, as described in this paper. Most of the existing proposals recommend the creation of a large "super-fund", yet this would be an unworkable vehicle to invest in the new, small and fast-growing areas of the UK economy which will drive its future sustainable economic growth. In addition, the public sector has no background in managing financial assets of this size.

The UK Growth Fund's structure seeks to take advantage of the appropriate and existing expertise in the public and private investment sector. Its fund-of-funds would be overseen by the most appropriate government-backed finance institution, with the UK Infrastructure Bank already mandated to use the blended finance instruments and approaches described in this report to crowd in private sector capital. The underlying investments in the sector-specific funds would be managed by private asset managers.

The need for a very substantial boost to investment in the UK is not in doubt. It is immensely positive that so many different organisations across the political spectrum are convinced of the need and possible mechanisms for private investors to meet this need. Some are more practical than others, some risk alienating partners in either the public or private sector. The proposal for a UK Growth Fund in this paper seeks to address these concerns to create an implementable and successful structure for channelling private savings into a sustainable and inclusive future.

---

67 Gov.uk, Chancellor Jeremy Hunt's Mansion House speech, 10 July 2023
68 The Labour Party, 5 Missions for a Better Britain

Steering economic change: how policy can promote stronger growth and shared prosperity

As the UK is buffeted by the economic shocks and challenges of the 2020s, The Economy 2030 Inquiry, a collaboration between the Resolution Foundation and the Centre for Economic Performance at the London School of Economics (LSE), funded by the Nuffield Foundation, is setting out a new economic strategy. To feed into this process we are publishing a series of externally-written policy essays. Each aims to provoke public debate on a specific policy area, and sketch out an agenda that will contribute towards the wider goal of the UK becoming a higher growth, lower inequality economy.

The essays cover topics ranging from the role of smarter regulation in supporting economic growth, ensuring that the goal of 'good jobs' is embedded in our national industrial strategy, and the role of the higher education sector in providing the skills needed to power our services dominated economy.

They are written by a range of leading economists and policy experts, and reflect the views of the authors rather than those of the Resolution Foundation, the LSE or The Economy 2030 Inquiry.

They have been commissioned and edited by Gavin Kelly (Chair of the Resolution Foundation and member of the Economy 2030 steering group) and various members of The 2030 Economic Inquiry team.