

LABOUR'S PLAN FOR A STRATEGIC INVESTMENT BANK

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Executive Summary

Overview

Growing Ireland's economy is a core priority for Labour. Expanding the flow of investment capital to grow employment and increase living standards is a key element of Labour's economic strategy.

The Irish Banking system neither offered the necessary levels nor required range of investment finance to Irish businesses – even during the boom. This gap has, with the banking crisis, become a chasm. In order to meet this critical requirement Labour is proposing the establishment of a Strategic Investment Bank in two phases:

Phase One. During its initial phase Labour's Strategic Investment Bank will act as an investment vehicle to channel funds (approximately €2.8 billion) from the National Pension Reserve Fund. It will focus on projects that will enhance infrastructure, boost growth and generate employment in the Irish economy. It will be fully independent and will follow international best practice commercial investment norms.

Phase Two. As market conditions improve Labour's Strategic Investment Bank will develop into a functioning bank, taking deposits and raising long term financing. €2 billion of the funds remaining in the National Pension Reserve Fund will be allocated as capital for Labour's Strategic Investment Bank.

Operation

Labour believes that the Strategic Investment Bank should be an essential component of Ireland's re-structured banking system. It draws on the German KfW Bankengruppe; the Japanese long-term credit banking system; the European Investment Bank (EIB); and European Investment Fund (EIF).

Labour's Strategic Investment Bank would operate on a strict arms-length basis from Government. Irish citizens and the Irish Diaspora would be encouraged to make deposits in the bank, and to purchase Citizen Bonds with differing maturities as a way of investing in the recovery of the Irish economy.

Labour's Strategic Investment Bank would also seek consumer deposits and access wholesale capital markets when conditions allow.

Labour's Strategic Investment Bank would be a key lender to small and medium sized businesses as well as innovative firms. It would also work closely with the Enterprise Agencies to facilitate high-potential firms.

Labour's Strategic Investment Bank could, following a detailed appraisal, invest in such companies seeking funds of between €2 million and €10 million. Its investment decisions would however remain the exclusive preserve of the bank.

Labour's Strategic Investment Bank would also support investment in large infrastructure and infrastructure-related projects.

Labour's Strategic Investment Bank will not be a high-street or 'retail' bank. It will have a small number of regional offices and an on-line presence.

By establishing a Strategic Investment Bank, Labour will create a wealth-generating productive legacy that will play a key role in Ireland's long-term prosperity.

Introduction

An investment economy

The core objective of Labour's economic policy is to replace Fianna Fáil's hit and miss approach with a strategic drive towards a sustainable investment economy, where innovation is promoted across all sectors, where there is an environment that promotes firm start-up and expansion, underpinned by the provision of world-class infrastructure. These elements are all closely interlinked.

Investment in infrastructure such as renewable energy, next generation communications networks, smart grids and electric transport will create the environment for a new wave of indigenous companies. They will be focused on the huge opportunities that will arise as a result of the expansion of digital technologies and the transition to a low-carbon economy over the coming decades. They must also have access to working and growth capital, as well as to a range of other supports.

Improved infrastructure will enhance Ireland's competitiveness and attractiveness as a location for foreign direct investment. In order to restore our competitiveness and productivity we need a sustained programme of investment in productive capital sectors such as transport, energy, communications and innovation, as opposed to squandering scarce resources on building ghost estates. Labour's plan will help create a wealth-generating productive legacy, as opposed to a debt burden, for future generations.

There are several major obstacles to be overcome in realising this vision. Irish Banks have a poor record of lending to small and medium sized businesses, and in particular to firms with high-growth potential – and requirements for working and growth/venture capital.

Ireland's fiscal position will impose severe restrictions on the level of public investment that can be directly financed by the exchequer.

The Long-term Case for a Strategic Investment Bank

Labour believes that the best medium-term way to address this capital and small business funding chasm is through the establishment of a Strategic Investment Bank. Labour's Strategic Investment Bank would develop both as a business bank, and as a public finance powerhouse that would radically change the manner in which public investment is appraised, planned and financed.

Labour's Strategic Investment Bank will be closely modelled on similar successful institutions elsewhere. These other state-backed national development banks, such as the German KfW (formed in 1948 to rebuild Germany's economy after WW2 and also played an key role in the economic redevelopment of eastern Germany following reunification) and the Japanese long-term credit banking system, were established at times of disruptive economic and social change – in particular where the market could not deliver the scale of investment required. The European Investment Bank (EIB) and the European Investment Fund (EIF) were created to further the objectives of the European Union by making long-term finance available for appropriate investments.

Funding small, medium and innovative, high-growth companies

The funding gap for businesses, in particular existing small, medium and innovative companies with high growth potential, represents a major handicap to growing Irish businesses and the Irish economy. Public policy must address these inter-related problems if we are to get our economy growing again and reposition it to successfully exploit future growth sectors.

Labour's Strategic Investment Bank could also, rather like certain European Investment Fund (EIF) initiatives, create specialised Development Capital Funds in order to sustain small business growth pre- and post-commercialisation with particular emphasis being placed on exports, the digital economy and low-carbon technologies.

Labour's Strategic Investment Bank would work in conjunction with Enterprise Ireland targeting companies for whom bank finance is either inappropriate or unavailable. Labour's Strategic Investment Bank could, following a detailed appraisal, invest in such companies seeking funds of between €2 million and €10 million. The possibility of scaling up the funding for such companies by attracting matching funds from the private sector to co-invest with Labour's Strategic Investment Bank will be carefully examined.

Labour's Strategic Investment Bank would also work in conjunction with Labour's proposed Innovation Strategy Agency (please refer to 'Labour's Plan for Enterprise, Innovation and Growth') to invest in the application of technological research and the commercialisation of appropriate intellectual property.

Labour's Strategic Investment Bank will not be a high-street or 'retail' bank. It will have a small number of regional offices and an on-line presence.

Financing capital investment

There are currently three methods of financing infrastructure in Ireland:

1. Direct Exchequer funding – for traditionally procured capital projects such as schools, hospitals etc.
2. Public Private Partnership (PPP) projects – originally for projects where there was a user charge like motorways but increasingly used for social infrastructure such as schools, hospitals and housing. These projects have been financed by non-recourse lending secured against user payments or payments from government to the private consortium, and
3. Debt financing of semi-state utilities – for example bonds raised by ESB and Bord Gáis.

A key reason for the development of the Irish PPP approach was to meet some of the nation's infrastructure needs without breaching EU restrictions on the level of the public deficit. The PPP system in Ireland, has, however, encountered a number of problems. Firstly, the cost of PPPs has been the subject of some criticism, particularly since the cost of funding PPP projects is greater than if the state were simply to borrow the money itself.

Secondly, the banking crisis has dramatically reduced the level of interest in PPPs among potential investors. The availability of finance for PPP projects from both domestic and foreign banks has effectively dried up since the credit crisis began. Where finance is still available, it is for shorter periods than the life of the infrastructure project in question and at a much greater cost. This effectively renders the PPP funding model unviable.

There is also nothing to suggest that the private banks have any appetite to continue financing such projects. We therefore need to radically alter the funding and delivery of infrastructure projects.

Instead of the current system where the private sector borrows expensively to build infrastructure that is then leased back to the state, Labour's Strategic Investment Bank would harness the ability of the state to fund capital investment and of the private sector to deliver projects on time and within cost. This approach will stimulate the economy, by procuring growth-enhancing assets, creating employment and supporting the investment economy.

A range of funding routes could be created and financial instruments generated by Labour's Strategic Investment Bank to implement this new approach. Financial instruments will vary depending on the specifics of the technology, project or business to be financed, however such a range of instruments could include:

- Debt – up to 50% of project finance to assist with the financing/refinancing of projects that require syndicated debt.

- Loan Guarantees – to reduce the cost of capital and improve access to capital markets.
- Insurance instruments – to insure key risks for which there are no market counterparties.
- Equity and hybrid funding for certain projects.

While it would continue to harness the ability of the private sector to deliver projects on time and within cost, Labour's Strategic Investment Bank would leverage the ability of the state (in normal market conditions) to fund capital spending significantly more cost-effectively than private operators. It would thus play to the respective strengths of both the state and the private sector.

Projects that could be funded by Labour's Strategic Investment Bank would include those with potential user charges such as roads, public transport, waste, communications and energy, and elements of social infrastructure including health, education and cultural facilities where the state pays an annual fee for use of the facility. The private consortium would repay Labour's Strategic Investment Bank over the duration of the project from user charges or else from the payments it would receive from the sponsoring department or agency for the construction, operation and maintenance of the project.

Funding from Labour's Strategic Investment Bank would reduce the cost of funds to private consortia, resulting in the provision of critical public infrastructure at a lower cost to the public purse and service users than that of current PPP system.

In more normal circumstances Labour's Strategic Investment Bank would be in a position to borrow on wholesale capital markets to invest in assets that would come with a revenue stream. Labour's Strategic Investment Bank would also channel funds from the European Investment Bank.

Capitalisation operation and governance of Labour's Strategic Investment Bank

Labour's Strategic Investment Bank will be established in two phases.

Labour's Strategic Investment Bank will initially be set up as a vehicle to invest funds from the National Pension Reserve Fund in projects that will enhance infrastructure and boost growth in the Irish economy. As market conditions improve, this vehicle will be developed into a functioning bank that takes deposits and raises long term financing.

Labour's Strategic Investment Bank would initially be capitalised by making a direct capital contribution from the National Pensions Reserve Fund of €2 billion.

When market conditions normalise Labour's Strategic Investment Bank will be in a position to issue its own long-term bonds with conservative leverage and to raise other forms of funding including deposits. Labour's Strategic Investment Bank would make no distribution of profits and all profits would be retained to increase the capital base of the bank. This will allow Labour's Strategic Investment Bank to progressively expand its investment in the Irish economy.

Labour's Strategic Investment Bank bonds would be issued in international capital markets and would also be offered to Irish and international pension funds and retail investors. It would also market retail bonds to the global Irish diaspora.

Labour's Strategic Investment Bank will be a statutory corporation whose functions and objectives would be set out in legislation. The Government would appoint the board of Labour's Strategic Investment Bank but it would act independently of government.

The Governance of the Bank, and the procedures used in financing individual infrastructure projects would be designed having regard to Eurostat rules that determine which institutions are regarded as being outside of the General Government sector. While Labour's Strategic Investment Bank would be wholly owned by the state, it will operate independently of Government and would not

therefore solely be an instrument of government policy. It would seek a commercial return on its investments in the areas of small and medium lending and provision of risk capital and the Government would not have the power to oblige it to enter into transactions that it did not believe to be economically viable. This level of autonomy would result in Labour's Strategic Investment Bank debt not being viewed as forming part of overall government borrowing.

In the long-term, we envisage a conservative capital ratio for the bank which would be set by the Financial regulator. The balance of lending between small and medium sized businesses and infrastructure projects would be a matter for the Board of the Bank and would be subject to commercial and prudential considerations. The amount of lending actually undertaken in this manner will depend on the number and scale of projects included in the National Development Plan (NDP) and the public capital programme that are deemed suitable for this form of financing. In many cases, Labour's Strategic Investment Bank will be in a position to act as a catalyst for additional funding from, for example, pension funds.

Labour in Government will bring forward a new NDP, and will regularly review the investment priorities of the state. These programmes will be reviewed and analysed by Labour's Strategic Investment Bank in order to advise the Government as to which are appropriate for funding. However the final decision on involvement in any project will rest with the Board of Labour's Strategic Investment Bank. The total share of any project financed by the bank will also be subject to commercial and prudential considerations. It may also be affected by Eurostat rules. As it will be an entirely independent entity, it will not impact on the government balance sheet.