Funding the Future

The savings bonds that could transform our future

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I wrote yesterday about my idea for issuing bonds to fund the new investment that will be required in the UK economy after coronavirus. My suggestion was that these bonds should be hypothecated in the sense that the proceeds of any issue should be used for the purpose that was designated at the time of their sale to a retail investor. Those retail investors would usually invest through an ISA or their pension fund.

I am now aware from the comments of a couple of financial services professionals on that post that there is some confusion as to the type of bond to which I was referring when making my suggestion. One speculated on this issue, and the other was quite sure that I was referring to what were, in effect, gilts i.e. the type of bonds already in existence and issued by the government.

This, however, is not what either I or Colin Hines, who has been my long-term collaborator on this project, have ever had in mind when discussing the issue of this type of bond through these types of personal investment wrapper. It has always been our belief that the bonds in question would, at least in the case of ISAs, and maybe in the case of personally invested pensions as well, be what we might call 'retail bonds'.

In practice, these retail bonds might be little different from what many might think to be long term deposit accounts held with a bank, which is why we suggest that they are either issued by a National Investment Bank, or maybe by National Savings and investments. Such an account would lock money up for, for example, five years at maybe 1% at present, or 10 years at maybe 1.5%.

Particularly in the ISA market we think that that this is what most investors want: a simple, straightforward and easy to understand product with a guaranteed rate of interest, albeit at a low rate with little upside potential, but where they know the funds in question might be put to good use. In the personal pension market this could also be of appeal: in the more sophisticated pension sector something more akin top a green gilt would also appeal, and I think should be made available.

It can be, and will be, argued that these bonds are not suitable for this purpose.

Rational investment managers say that no one should hold cash at present because it is clearly deteriorating in value given inflation and the very low rates of interest paid. But, despite that, hundreds of billions of pounds are held in cash in ISAs and, even, pension funds, whilst the gilt holdings of pension funds remain relatively high, again running into hundreds of billions of pounds, despite the fact that many of them pay negative real interest rates. And, of course, there are hundreds of billions of pounds more in cash held on simple bank deposit accounts. Rationality, in the sense that investment managers use the term, clearly does not come into many retail investors' decision-making.

There are three, very good, reasons for that. The first is that very few retail investors understand what investment managers mean by rationality, and so question it. Secondly, those retail investors do not believe the assurances provided by investment advantages that current markets are rational. They look at the very obvious disconnect between, for example, market prices for shares and the very apparent risks within the economy, and suggest that it is the investment managers who have departed from reality. Third, retail investors want what I am suggesting, which is an investment that does result in real economic activity in the communities in which they live for the benefit not only of themselves, but for others in those places, including their own children. Based on the comments made, some investment managers do not get this, but that is their problem, not mine.

My logical conclusion, based upon this analysis, is that there is a massive market for what look like cash based savings products but which are related to real economic activity, which is precisely what I am trying to promote for the combined reason of tackling the cash glut that exists, and to provide the capital that society needs for the economic and social transformation that it must undertake. If an investment manager cannot understand this reconciliation of goals, again, that is a problem in bedded in their view of rationality, which is far removed from what the real world sees as being so.

But, I do accept that the retail bond does give rise to issues. The obvious one is that this creates a mismatch between the potential risk between the underlying investments, the returns that they can make, and the desire implicit in the Green New Deal to, for instance, create long term, well paid jobs. I have to be honest and say that there is no guarantee that the investments that the bonds I propose will fund will earn a sufficient return to cover the interest that I suggest should be paid. They might, of course make that return, but given the criteria for investment may well not be solely economic it is just as likely that they will not.

This, however, does not undermine the credibility of the offering, which has been constructed for the precise reason of moving unused cash into productive activity. Instead, it justifies the description of these bonds as being part of green quantitative easing. Green QE would play three rolls in this offering.

First, if there was an investment shortfall then green QE would be used to make good that difference. In other words, the government would create the money necessary to guarantee the return to the investors, even if the underlying investment could not. That is because that investment would, of course, be undertaken for social purpose. The whole purpose of the bonds would be to provide most of the capital, in effect leveraging the activity. But, entirely appropriately, the government would remain at risk, and would therefore in affect create the equity capital through green QE.

Second, the government would similarly use green QE to make sure that there was a liquid market with regard to redemption of these bonds, if that is what a holder required. Once more, the amount of QE that would be required in this case would be vastly less than the total capital used, which means that the goal of reallocating cash into useful activity would still be achieved with limited distortion from a new QE resulting.

Third, Green QE would provide the backstop so that if, at the end of a bond term, there were no new subscriptions then full redemption could take place, and the project could continue unimpeded. I think that the prospect of this is incredibly unlikely, but again this is the government acting as guarantor (a role with which it is entirely familiar inside financial markets) rather than as the primary provider of capital.

Put these three aspects together, and the investor has a guaranteed return, the government has access to the capital it needs without recourse to QE or taxation, social purpose is achieved, and excess liquidity within the financial markets which is at present being used for speculative purposes to absolutely no gain to society is reduced. Those are massive multiple wins.

So, some final thoughts. First, is this product suitable for recommendation? Yes, of course it is, to those people who want an alternative to the current extremely secure cash or gilt based savings. That does not mean it is suitable for everyone.

Second, would anyone be compelled to take these investments? No, of course they would not. But if they wanted the benefit of tax reliefs then this would be the option available to them, and that is an entirely appropriate use of government subsidy. My suggestion to anyone who disagrees is that they try to provide justification for the current systems of subsidy for savings, which reallocated more than £60 billion of subsidy each year to those who are already wealthy because they have the ability to save, including for their own old age.

Third, to those who say that this product is not suitable for pension fund investment, I would suggest that they try to explain the existing real profile of risk with in the pension portfolios that most people have, given the massive uncertainties within both the bond and stock markets, and then see peoples own choices: I very strongly suspect that they would go for the safety that this route offers, despite the lower returns.

Finally, to those within financial services who wish to challenge this suggestion, might I ask that they come up with a better macro economic explanation of how the savings and investment market might be reprofiled to meet the social capital investment programme that I am proposing? Or is it that they simply think we do not need to act to improve our physical and social infrastructure, and to tackle climate change?

I will also offer one afterthought. I sat next to a very senior actuary from a very large pension fund a year or two ago. He assured me that his fund was guaranteed to be successful, because given the current profile of investments within it, his investment portfolio was guaranteed to burn the planet to extinction before most of the people for whom he was investing could die. As a consequence, if there were any survivors of coming global meltdown, their pension would be phenomenal. He fully understood the risk in the current pension investment, but was constrained by conventional market logic. I am not, and what I am doing is proposing a solution that defeats the nihilism within that logic.