

GIIA: The Future of UK Infrastructure

Summary

Investors in infrastructure – typically overseas and domestic pension funds, specialist fund managers, insurance companies and sovereign wealth funds – are ready and willing to help the country to rebuild following COVID-19 and achieve long-term societal objectives such as reaching net zero emissions by 2050. Between 2016 and 2021 nearly £19bn has been invested in the UK offshore wind sector alone, and with \$200 billion of ‘dry powder’ ready to be deployed, global investors are poised to create new jobs right across the country and deliver on the Government’s renewed levelling up agenda.

There are, however, a range of challenges that risk undermining fuller delivery of the country’s infrastructure ambitions. It is vital that we address these challenges head-on, with companies and investors working in partnership with Government and regulators, to unlock the private investment needed to create economic growth and secure our long-term economic prosperity.

GIIA, as the membership body for the leading international infrastructure investors, has been engaging with investors, advisers and stakeholders to set out the challenges that lie ahead as well as some of the solutions, in the shape of three new reports:

- **Unlocking Capital for Net Zero Infrastructure¹**, in partnership with PwC, identifies the need for £400bn of investment in infrastructure over the next 10 years to meet the UK’s net zero target and provides a set of targeted recommendations for how to deliver this investment.
- **The Future of Regulation²** looks at what the UK’s system of economic regulation has delivered over the past few decades and how it needs to be updated to ensure that the providers of regulated infrastructure assets can realise the transformation required in the next few decades.
- **Public Private Partnerships – Global Comparisons and Lessons Learnt**, in partnership with DLA Piper, reviews the global lessons from funding and financing models and sets out specific measures which could help to bring private capital into Government-led projects and drive forward project delivery.

In this note, we draw together the findings of these various reports and outline a consolidated set of recommendations, that, when taken together, would help deliver a step-change in the UK’s infrastructure.

¹ GIIA and PwC, Unlocking Capital for Net Zero Infrastructure, [URL](#)

² GIIA, The Future of Regulation, [URL](#)

Context

Government set an ambitious plan for infrastructure in its 2019 manifesto, which set out its aims to level up the regions and nations of the UK and position the UK as a global leader on climate change ahead of hosting the United Nations COP26 summit. While COVID-19 has significantly affected the delivery of the wider political programme, infrastructure investment is more important than ever to support Government's plans for economic recovery, creating jobs and developing new industrial capabilities which are sustainable in the long term.

During the pandemic, the UK's infrastructure has stood up well. Our water and energy networks have remained resilient and our broadband networks have risen to the challenge of mass home-working. We start from a good base.

Looking ahead, the Global Infrastructure Index Research (published by GIIA and Ipsos MORI)³ shows that 83% of people believe that investment in infrastructure will create new jobs and boost the economy. But despite this support, the UK lags behind when it comes to public expectations on infrastructure delivery – 65% of people think Britain is not doing enough to meet infrastructure needs, higher than both the global figure (59%) and all G8 countries (57%).

The challenge of continuing to deliver high-quality infrastructure in the UK is growing. The overall level of investment required to reach long-term policy objectives – such as net zero emissions and the digital agenda – will increase dramatically. Both the nature and size of the challenge will change.

Government's long awaited National Infrastructure Strategy recognises the importance of private investment to address these long-term challenges. The Strategy also places emphasis on the role that pension funds can play in delivering this investment, and the need to remove regulatory barriers in the way of UK savings being directed more fully at long term illiquid assets, including infrastructure. HM Treasury expects private investment to provide at least half of the capital required for infrastructure to meet the Government's objectives and acknowledges that more needs to be done to mobilise capital across the economy. In addition, the regulatory regime needs to be updated to reflect the challenges we face today to ensure that this private sector investment can be unlocked at lowest possible cost, enabling the Government to deliver on its ambitions.

The Energy White Paper and HMT's Interim Net Zero Cost review recognise the scale of investment required to realise the transition to net zero. Much of this will have to be financed by the private sector which means we need the right commercial models for technologies such as CCUS, hydrogen and nuclear to unlocking private investment. Government can play a supportive role by providing a stable policy, regulatory and fiscal environment to attract private capital. It can also cut the overall cost of the transition by taking on risks that the private sector is poorly placed to bear, for example, through financing mechanisms such as the Contracts for Difference model or allowing regulated revenues. The new National Infrastructure Bank could also play a crucial role by intervening to correct market failures by providing debt guarantees or taking equity stakes in projects to crowd in private capital.

Recent shift in approach on private investment

Historically, the UK led the way. It pioneered private financing models and regulatory frameworks which have been replicated globally and delivered significant investment across a range of sectors.

³ GIIA, Global Infrastructure Index 2020, [URL](#)

This investment has brought private sector expertise and innovation to the delivery, operation and maintenance of assets. Regulation worked on the basis that, where possible, the market is best placed to ensure services are delivered efficiently, to a high quality, and at lowest overall cost. The regime realised significant benefits for consumers as a result.

However, there has been a notable shift in recent years in the approach of Government and regulators to private investment in infrastructure. This has been driven in part by concerns around whether the PFI model and regulated monopolies were best placed to deliver value for money. These concerns have been compounded by a perception that UK consumers were paying over the odds, leading to a shift in political and regulatory focus to keeping consumer bills as low as possible in the aftermath of the financial crisis.

The frameworks that mobilised significant investment over the last 30-40 years are at risk of being undermined and impacting our ability to deliver a greener, more resilient, and digitally enabled economy out to 2050 and beyond.

Recommended actions

Building on the National Infrastructure Strategy, we now need a coordinated approach to tackling these long-term challenges and mobilising private investment across the economy. Government, regulators, industry and investors must work together to ensure the case for private investment in the UK's infrastructure market remains strong.

GIIA's recent reports – Unlocking Capital for Net Zero Infrastructure and The Future of Regulation – make a number of recommendations on how to improve the current framework.

They do not envision starting from scratch. Rather, the principles that govern investment frameworks should be updated so that they are fit for purpose in light of the greater challenges ahead. These reforms would build on the successful outcomes that private investment has generated to date and ensure that future generations can continue to benefit from the UK's world-leading approach.

We see three major areas of focus for reform that should be prioritised by Government, regulators and the wider infrastructure sector:

- Increasing competition to drive value for money
- Improving the relationship between the public and private sectors
- A greater focus in regulation on delivering long-term objectives

Increasing competition to drive value for money

Since its creation, the UK's system of economic regulation has brought significant benefits to the economy and broader society. Many of the challenges that were experienced during public ownership have been addressed, with the networks industries consistently outperforming the rest of the economy in productivity measures. In particular, the approach has attracted around £150bn of investment in water networks – almost double pre-privatisation levels – and £45bn was invested in energy networks and generation between 2010-13 alone. This investment has

delivered tangible economic benefits right across the UK and laid the groundwork for a modern, digital economy.

However, foreign direct investment (FDI) levels overall into the UK have been on a downward trend for several years. The House of Commons Library shows that by 2019, FDI had fallen for the third year in a row since 2016, having peaked at £192.6bn in 2016, to £35.6bn in 2019⁴. At the same time, global flows of FDI increased by an average of 3% over the same time period to \$1.5tn in 2019, demonstrating the pace at which the UK has fallen behind competitors in the race for global capital investment⁵.

To succeed, the UK needs to remain attractive in the global market. Getting the investment environment right will promote competition for investment opportunities in the UK, helping to drive value for money and increasing overall levels of much needed FDI.

Reform should therefore be focussed on the following areas:

- **Government must set out a strong pipeline of projects** built on a detailed roadmap to achieving policy objectives. This will provide clarity on the investment opportunities in the UK, encouraging competition. Government's National Infrastructure Strategy gives a high-level view, but Government now needs to work with industry to provide further detail on specific actions and projects in each sector.
- **Government should improve the procurement of PPPs** by streamlining processes and assessing value for money based on factors other than cost alone. This would increase competition and drive the roll out of assets by minimising delivery and reputational risk. The Government would 'crowd in' private sector investment.
- **Regulators and Government should take specific steps to incentivise innovation over the long-term.** This would ensure that companies align their work to improve service delivery and capability with long-term objectives which yield commercial outcomes. It would push against more recent approaches to regulation which have weakened incentives to innovate by focusing on short term consumer bills. The role of arm's length bodies such as Innovate UK, and the catapult centres will be important in this regard.
- **Government should carefully consider the application of powers granted by the National Security and Investment Bill.** The scope of the draft legislation currently making its way through Parliament, is very wide and the threshold for mandatory notification is set relatively low, meaning that a large volume of notifications can be expected when the regime is operational. The unit tasked with managing these notifications must be fit for purpose as soon as the regime is operational, and it should work to avoid lengthy delays in the approval of transactions. Further, the ability for the Government to act retroactively by 'calling in' deals up to 5 years after completion risks dampening the incentives to invest in the UK. Accordingly, this power should be exercised sparingly. The regime must also be established with a clear focus on providing informal early advice to investors in the initial stages of transactions to ensure the UK continues to be perceived as a positive destination for foreign investment.

⁴ House of Commons Library, FDI Statistics, (December 2020), [URL](#)

⁵ Ibid

Improving the relationship between the public and private sectors

Over recent years the relationship between the public and private sectors has become more fraught. Most notable are the Labour Party's nationalisation agenda and the ending of PFI/2 contracts. However, it is clear that private sector expertise, innovation and investment will be integral to addressing the challenges ahead. We have made several recommendations to recalibrate the relationship between the public and private sectors:

- **Government and regulators should ensure an appropriate balance between risk and reward through identifying preferred funding models.** This applies both to the delivery of new projects and investment in existing assets. Where the revenue model is underdeveloped, for example in nascent markets such as hydrogen and CCUS, we recommend that Government funds are targeted at reducing the risk that must be borne by private investors so as to draw in private capital. Thames Tideway has shown that this can be just as successful through the regulatory model as PPPs. The new UK National Infrastructure Bank should be focussed on deploying this type of capital support for infrastructure but it is important that the Bank is mandated to remain arm's length from day to day political interference and that there is broad stakeholder acceptance of the fact that a proportion of investments might fail. As an example, the Canada Infrastructure Bank was mandated to lose up to CAD\$15bn over ten years. Perhaps most importantly, the Bank should be established with a clear objective to focus on interventions where private investment will not otherwise venture alone, in order to have a 'crowding in' effect for longer term, lower risk infrastructure investors.
- **Government must ensure sufficient flexibility in contracts** to allow for efficient management and operation of assets. This approach will harness the expertise and experience of the private sector to realise best value for money for consumers and taxpayers. The pandemic has forced Government to take a more partnerial approach to managing PPPs, such as for hospitals and schools, and the lessons learnt should be applied to future contracts.
- **Industry, investors, Government and regulators must work together to improve project management reporting and build an evidence base on the benefits of PPPs.** Currently, Government has little data to inform decisions on the most appropriate approach to private investment. Developing this evidence base will ensure that an accurate evaluation of the value of private investment in, and operation of, infrastructure can be made. This will not only improve future financing decisions, but also help to rebuild trust in private sector capabilities.
- **A clearer division of roles and responsibilities between Government and regulators** is necessary to eliminate perceived political interference, whilst aligning long-term objectives. This will reduce risk for investors and provide sufficient certainty to facilitate investment in long-term projects.
- **Government and regulators should directly consider the long-term impact of decisions,** including intergenerational equity, for investors to have sufficient confidence to invest. The challenges to infrastructure are inherently long-term. Each project should have strong political backing which is grounded in a clear investment case rather than determined by the issue of the day. This will de-politicise decision making and help to rebuild trust in the private sector.

A greater focus on regulation delivering long-term objectives

There is no need to tear up the UK's regulatory regime and wider framework for infrastructure investment. However, it does require updating to ensure that it remains fit for purpose. This will ensure the regime continues to be able to deliver significant benefits for the public, companies and investors. As outlined in our report 'The Future of Regulation', we propose the following changes to the regulatory regime:

- **Government needs to update the duties of each sectoral regulator to reflect future challenges**, such as the need to deliver net zero emissions by 2050 and support regulators to make transparent trade-offs where necessary. Government has suggested in the National Infrastructure Strategy that it will set out its proposals in this area in an overarching policy paper on economic regulation due in 2021. It should make a clear decision on this at the earliest possible opportunity to provide clarity for the regulated sectors.
- **Regulators and Government should work to ensure the frameworks for investment are consistent across the economy**. This would improve predictability and help investors, particularly those operating internationally, to navigate the market. For example, a consistent approach to determining allowed returns across regulated sectors could be a step in the right direction. However, we do not see any value in merging sectoral regulators. We are also not calling for all regulators to use identical approaches, rather that they should draw from similar principles that parties across all sectors have bought into. This will help improve the long-term predictability and stability of the regime.
- **Government must ensure that the regulatory appeals regime remains robust**. As the CMA changes post-Brexit to take on new responsibilities, it is important that regulatory appeals are not watered down. The current merits-based appeals mechanism is a critical part of the overall framework and should be protected. It provides significant confidence to investors that regulators can be held to account so that they will make properly independent, evidence-based decisions.

It is clear that the UK's regulatory regime needs a reboot. To some extent the Government has already recognised this – as demonstrated by the fact that HM Treasury commissioned the NIC to undertake a study on economic regulation and has also commissioned a report into the competition and regulatory frameworks led by John Penrose MP, expected to report before the Budget in March 2021.

One of the key objectives of any regulatory reform should be to create a regime that aligns the interests of consumers in both the short and long term. This means ensuring that we continue to drive value for money to keep bills low, but also turbocharge the investment needed now to prepare for the long-term challenges ahead. This is at the core of what the regulatory settlement was always intended to achieve but it has been increasingly challenged in recent years.

Conclusion

It is critical that the Government, regulators and investors work together on these core areas in order to stand a chance of delivering on the scale of ambition for UK infrastructure. The UK has a solid base from which to shape an attractive and dynamic infrastructure market. This will ensure we can make the Government's plans to level up the country and reach net zero by 2050 with a digitalised and even more resilient economy a reality. But failure to act will cause the UK to lose

its competitive edge in the global infrastructure market, and with it, the ability to propel the country forwards in its economic recovery from COVID-19.

Annex 1: Key 2021 Strategies, Consultations and Events

Consultation / Event	Key Department / Organisation	Expected publication
UK Hydrogen Strategy	BEIS	February
The Williams Review	Department for Transport	February / March
2021 Budget	HMT and relevant Departments	3 rd March
Creation of National Infrastructure Bank	HMT	3 rd March
CMA decision on PR19 appeals	CMA and Ofwat	By 18 th March
Launch of RIIO-2 CMA appeals – gas transmission and distribution, electricity transmission and ESO	CMA and Ofgem	End of March
Heat and Buildings Strategy	BEIS	Q1
North Sea Transition Deal	BEIS	Q1
Net Zero Review	HMT	Q2
National Infrastructure and Construction Pipeline	IPA	Q2
Updated Green Book guidance on net zero	HMT	Q2/3
Transport Decarbonisation Plan	DfT	Summer
Introduction of Green Gas Levy	BEIS	Autumn
Net Zero Strategy	HMT, BEIS	Before COP26 in November
COP26	BEIS	1 – 12 November
Overarching Policy Paper on Economic Regulation	HMT, BEIS	2021
Consultation on Strategy and Policy Statement for Ofgem	BEIS	
EV Charging Infrastructure Strategy	DfT and BEIS	