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Why Germany Leads in Renewables: It Has Its Own Green Bank

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*The Green New Deal endorsed by **Alexandria Ocasio-Cortez** and more than 40 other US Representatives has been criticized as imposing a too-heavy burden on the rich and upper-middle-class taxpayers who will have to pay for it, but taxing the rich is not what the Green New Deal resolution proposes. It says funding will come primarily from certain public agencies, including the Federal Reserve and "a new public bank or system of regional and specialized public banks."*

Funding through the Federal Reserve may be controversial, but establishing a national public infrastructure and development bank should be a no-brainer. The real question is why we don't already have one, like China, Germany, and other countries that are running circles around us in infrastructure development. Many European, Asian and Latin American countries have their own national development banks, as well as belonging to bilateral or multinational development institutions that are jointly owned by multiple governments. Unlike the US Federal Reserve, which considers itself "independent" of government, national development banks are wholly owned by their governments and carry out public development policies.

China not only has its own China Infrastructure Bank but has established the Asian Infrastructure Investment Bank, which counts many Asian and Middle Eastern countries in its membership, including Australia, New Zealand, and Saudi Arabia. Both banks are helping to fund China's trillion-dollar "One Belt One Road" infrastructure initiative. China is so far ahead of the United States in building infrastructure that Dan Slane, a former advisor on President Trump's transition team, has warned,

> "If we don't get our act together very soon, we should all be brushing up on our Mandarin."

The leader in renewable energy, however, is Germany, called "the world's first major renewable energy economy." Germany has a public sector development bank called KfW (*Kreditanstalt für Wiederaufbau* or "Reconstruction Credit Institute"), which is even larger than the World Bank. Along with Germany's non-profit Sparkassen banks, KfW has largely funded the country's green energy revolution.

Unlike private commercial banks, KfW does not have to focus on maximizing short-term profits for its shareholders while turning a blind eye to external costs, including those imposed on the environment. The bank has been free to support the energy revolution by funding major investments in renewable energy and energy efficiency. Its fossil fuel investments are close to zero. One of the key features of KFW, as with other development banks, is that much of its lending is driven in a strategic direction determined by the national government. Its key role in the green energy revolution has been played within a public policy framework under Germany's renewable energy legislation, including policy measures that have made investment in renewables commercially attractive.

KfW is one of the world's largest development banks, with assets as of December 2017 of $566.5 billion. Ironically, the initial funding for its capitalization came from the United States, through the Marshall Plan in 1948. Why didn't we fund a similar bank for ourselves? Apparently because powerful Wall Street interests did not want the competition from a government-owned bank that could make below-market loans for infrastructure and development. Major US investors today prefer funding infrastructure through public-private partnerships, in which private partners can reap the profits while losses are imposed on local governments.

KfW and Germany's Energy Revolution

Renewable energy in Germany is mainly based on wind, solar and biomass. Renewables generated 41% of the country's electricity in 2017, up from just 6% in 2000; and public banks provided over 72% of the financing for this transition. In 2007-09, KfW funded all of Germany's investment in Solar Photovoltaic. After that, Solar PV was introduced nationwide on a major scale. This is the sort of catalytic role that development banks can play, kickstarting a major structural transformation by funding and showcasing new technologies and sectors.

KfW is not only one of the biggest but has been ranked one of the two safest banks in the world. (The other is also a publicly-owned bank, the Zurich Cantonal Bank in Switzerland.) KfW sports triple-A ratings from all three major rating agencies, Fitch, Standard and Poor's, and Moody's. The bank benefits from these top ratings and from the statutory guarantee of the German government, which allow it to issue bonds on very favorable terms and therefore to lend on favorable terms, backing its loans with the bonds.

KfW does not work through public-private partnerships, and it does not trade in derivatives and other complex financial products. It relies on traditional lending and grants. The borrower is responsible for loan repayment. Private investors can participate, but not as shareholders or public-private partners. Rather, they can invest in "Green Bonds," which are as safe and liquid as other government bonds and are prized for their green earmarking. The first "Green Bond – Made by KfW" was issued in 2014 with a volume of $1.7 billion and a maturity of five years. It was the largest Green Bond ever at the time of issuance and generated so much interest that the order book rapidly grew to $3.02 billion, although the bonds paid an annual coupon of only 0.375%. By 2017, the issue volume of KfW Green Bonds was $4.21 billion.

Investors benefit from the high credit and sustainability ratings of KfW, the liquidity of its bonds, and the opportunity to support climate and environmental protection. For large institutional investors with funds that exceed the government deposit insurance limit, Green Bonds are the equivalent of savings accounts, a safe place to park their money that provides a modest interest. Green Bonds also appeal to "socially responsible" investors, who have the assurance with these simple and transparent bonds that their money is going where they want it to. The bonds are financed by KfW from the proceeds of its loans, which are also in high demand due to their low interest rates; and the bank can offer these low rates because its triple-A ratings allow it to cheaply mobilize funds from capital markets, and because its public policy-oriented loans qualify it for targeted subsidies.

Roosevelt's Development Bank: The Reconstruction Finance Corporation

KfW's role in implementing government policy parallels that of the Reconstruction Finance Corporation (RFC) in funding the New Deal in the 1930s. At that time US banks were bankrupt and incapable of financing the country's recovery. Roosevelt attempted to set up a system of 12 public "industrial banks" through the Federal Reserve, but the measure failed; so he made an end run around his opponents by using the RFC that had been set up earlier by President Hoover, expanding it to address the nation's financing needs.

The RFC Act of 1932 provided the RFC with capital stock of $500 million and the authority to extend credit up to $1.5 billion (subsequently increased several times). With those resources, from 1932 to 1957 the RFC loaned or invested more than $40 billion. As with KfW's loans, its funding source was the sale of bonds, mostly to the Treasury itself. Proceeds from the loans repaid the bonds, leaving the RFC with a net profit. The RFC financed roads, bridges, dams, post offices, universities, electrical power, mortgages, farms, and much more; and it funded all this while generating income for the government.

The RFC was so successful that it became America's largest corporation and the world's largest banking organization. Its success may have been its nemesis. Without the emergencies of depression and war, it was a too-powerful competitor of the private banking establishment; and in 1957, it was disbanded under President Eisenhower. The United States was left without a development bank, while Germany and other countries were hitting the ground running with theirs.

Today some US states have infrastructure and development banks, including California; but their reach is very small. One way they could be expanded to meet state infrastructure needs would be to turn them into depositories for state and municipal revenues. Rather than lending their capital directly in a revolving fund, this would allow them to leverage their capital into 10 times that sum in loans, as all depository banks are able to do. (See my earlier article here.)

The most profitable and efficient way for national and local governments to finance public infrastructure and development is with their own banks, as the impressive track records of KfW and other national development banks have shown. The RFC showed what could be done even by a country that was technically bankrupt, simply by mobilizing its own resources through a publicly-owned financial institution. We need to resurrect that public funding engine today, not only to address the national and global crises we are facing now but for the ongoing development the country needs in order to manifest its true potential.

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