Better Regulation for Long Term Investments

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Public finance of advanced economies is under stress. The levels of public debt of G-7 countries soared to post-war levels. Restoring sustainable debt will be a very challenging task.

Strong inflation could reduce public debt. But high inflation distorts the allocation of resources, reduces the growth rate, hits the poorest citizens, creates social and political instability.

Major cuts in public spending are possible, but politically difficult. They may seriously jeopardize the Governments political consensus.

Together with relevant but sustainable cuts in public spending, increasing the average rate of GDP growth is then the most desirable solution to reduce public debt to GDP ratios.

It is not easy to achieve. Reforms to liberalize markets, boost competition and cut regulatory burdens are always necessary, but, alone, have shown not to be able to achieve the desired results as yet. A further demand-side boost for the economy, like to the one recently enacted by US and China, is needed.

Investment in strategic sectors – like infrastructures, research and technological innovation, environment, alternative energy sourcing, biotechnologies – could foster economic growth and enhance competitiveness and productivity.
But, where do we get the resources to finance these investments? European countries could not do so with budget resources as high growth and low public debt countries (such as China, Korea, Russia, Australia) can do.

Therefore, Europe, should enact policies to raise (to attract) capital from the private sector and from extra European public and private sectors for financing European strategic investments.
Historically Europe has high household savings rates. The Household savings may be a very important asset.

With new rules, incentives and financial instruments, Euro denominated investments could became more attractive also for financial capital surplus countries searching a way to diversify their asset allocation.

A new regulatory framework - more friendly with long term investment or, at least, not discriminatory against it - is needed. It should involve accounting standards, prudential principles, and corporate governance, as well as "ad hoc" systems of fiscal incentives.

As for the accounting standards, the “mark to market” principle does not permit distinctions between short-term and long-term investment values in balance sheets. There is need to i) introduce accounting criteria that reflect long-term investors specific business model; ii) distinguish between different temporal durations/matching liabilities and investments; and ii) take into account the value of future cash flow over the long-term.

In many European Countries tax systems, the long term investments are disadvantaged compared to financial short term investments. These discriminatory disincentives should be abolished. We may moreover think to introduce “ad hoc” incentives long-term initiatives of general interest, as granted to the US Project Bonds or awarded to the renewable energy projects.

As for the European new financial instruments, the first examples are the “2020 European Fund for Energy, Climate Change and Infrastructure” (Marguerite) and the Inframed Fund. Other common financial instruments should be considered, such as Project Bonds, Eurobonds and Guarantee Schemes.

Financing EU long term investments will create value for next generations, give a contribution to restore fiscal stability, strengthen growth and increase public and common goods.