EUROPEAN PARLIAMENT

Economic and Monetary Affairs Committee

Financial, Economic and Social Crisis Committee

Better Regulation for Long Term Investments

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Chairman of Cassa Depositi e Prestiti

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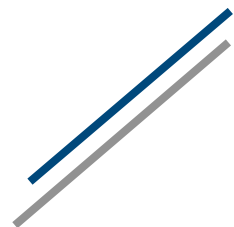
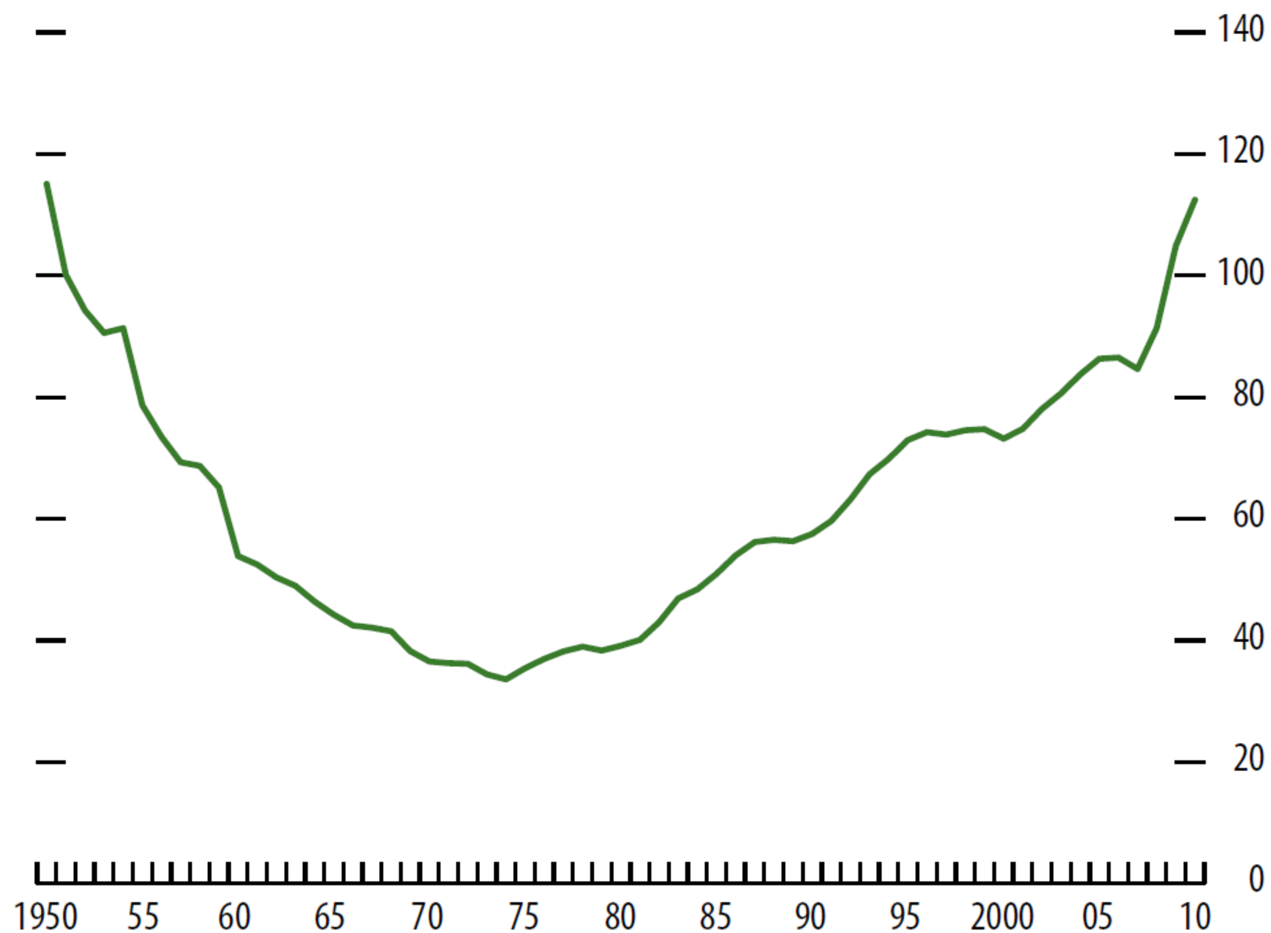


- **Public finance of advanced economies is under stress.**
- **The level of public debt/GDP ratio of G-7 countries soared to post-war levels.**
- **For the "advanced economies" within the G-20, this ratio peaked to 102% in 2009 and is expected to reach 122% in 2014.**
- **According to IMF, 10 to 15 years of fiscal adjustment are needed to return to pre-crisis levels of public debt.**

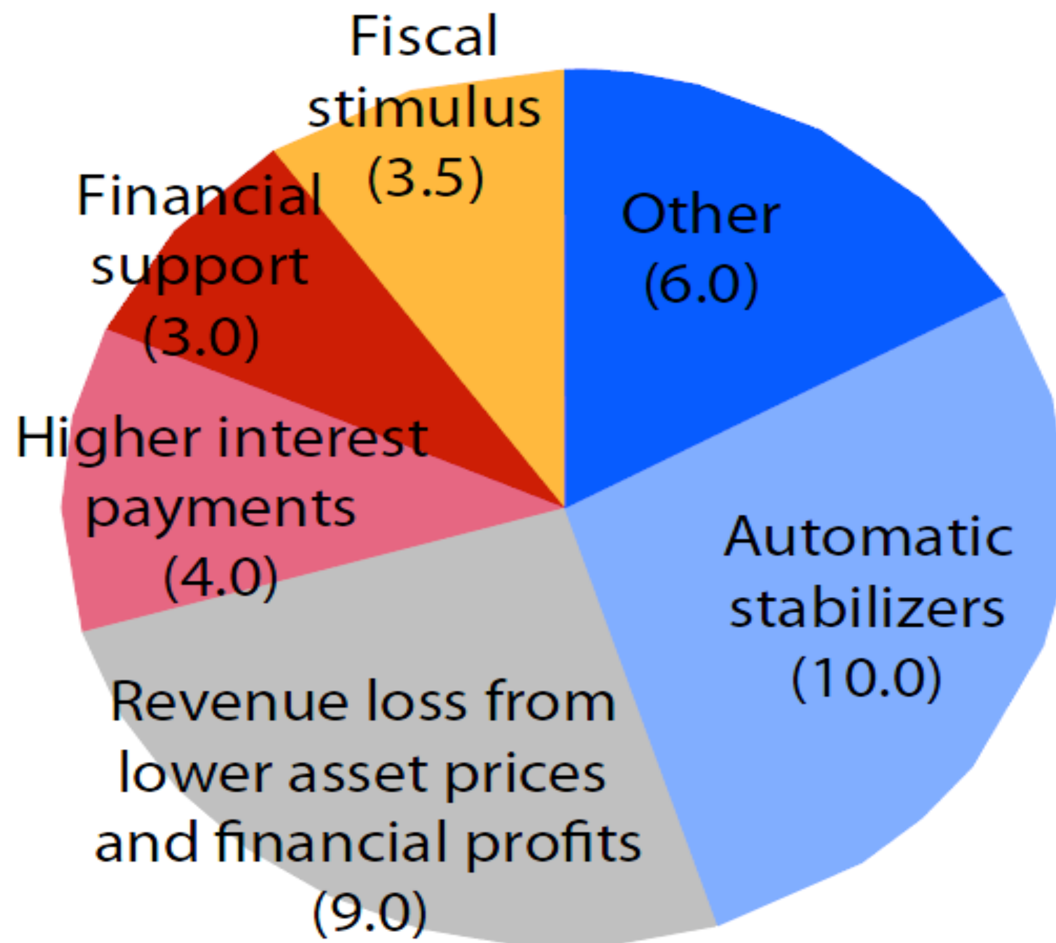
Sovereign Debt to GDP (%) in the G-7



Source: IMF, *Global Financial Stability Report*, April 2010.

- **Public budgets are drained by government interventions to save financial institutions and other sectors hit by the crisis.**
- **Revenue losses, automatic stabilizers, and higher interest payments constitute the main part of government debt increase.**
- **Most advanced economies need to lower their deficits and their debt substantially.**
- **Some of them are already experiencing strong financial market pressures to do so.**

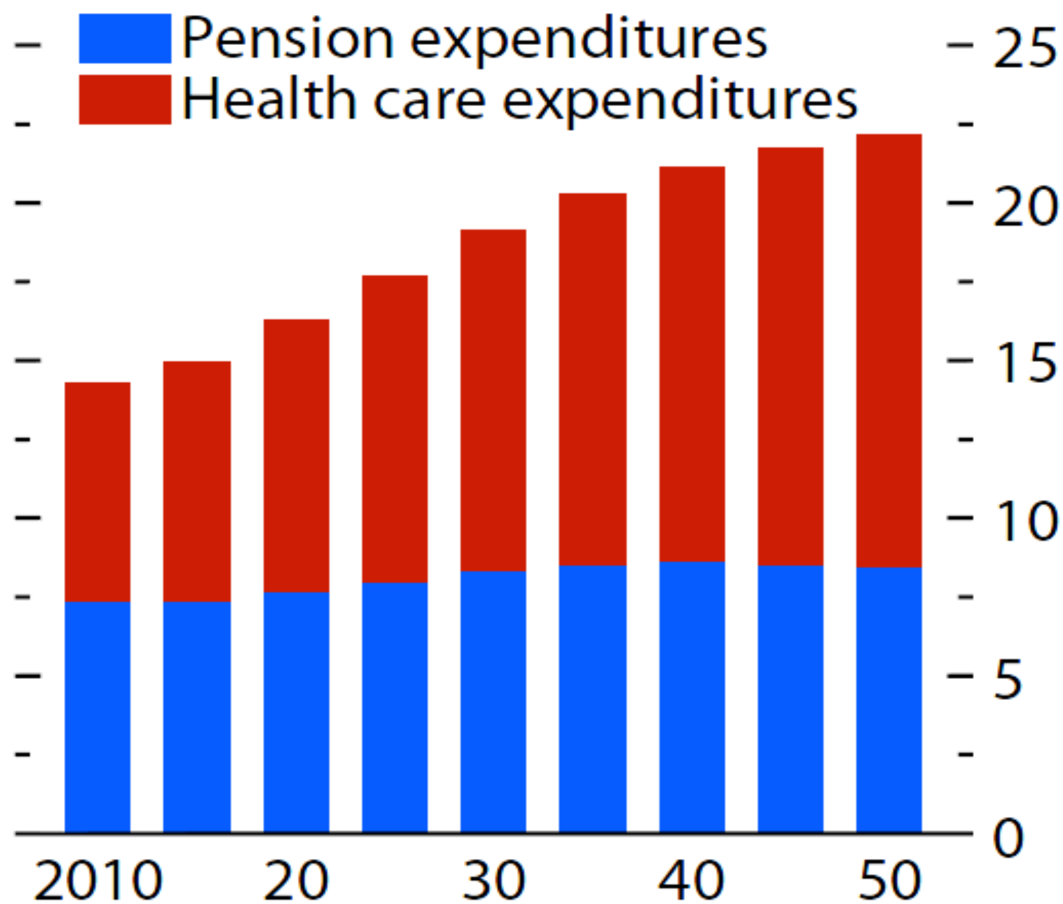
Decomposition of Government Debt Increase, 2007-2014



Source: IMF, *World Economic Outlook*, April 2010.

- In the coming years, the debt reduction will have to face the negative effects of low growth rates and the increasing costs of the welfare state.
- In addition, the economy should supports a growing population of ageing citizens.
- The problem is therefore “structural” not just cyclical.
- Restoring sustainable debt over the medium term will be indeed a very challenging task.

Ageing-Related Spending in G20 Advanced Economies



Source: IMF, *World Economic Outlook*, April 2010.

- **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.**

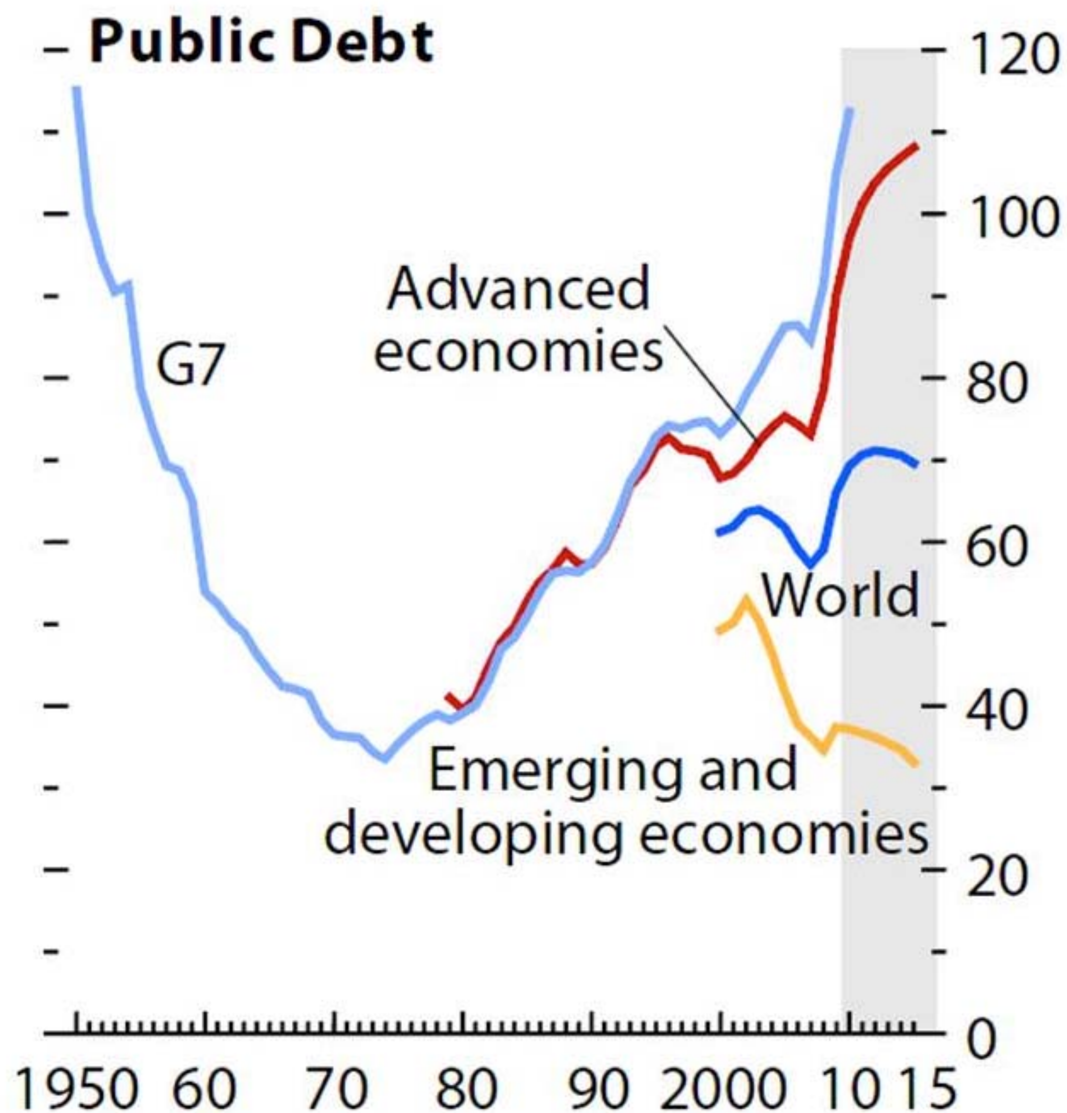
- **Together with relevant but sustainable cuts in public spending, increasing the average rate of GDP growth is then the most desirable solution to reduce public debt to GDP ratios.**

- **Together with cuts in public spending, increasing the GDP growth rate is the most desirable solution to reduce public debt to GDP ratios.**
- **Reforms to liberalize markets, boost competition and cut regulatory burdens are necessary, but, by themselves, they proven not to be able to achieve the desired results.**
- **Investment in strategic sectors – like infrastructures, research and technological innovation, environment, alternative energy sourcing, biotechnologies – could foster economic growth and enhance 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 and are doing.

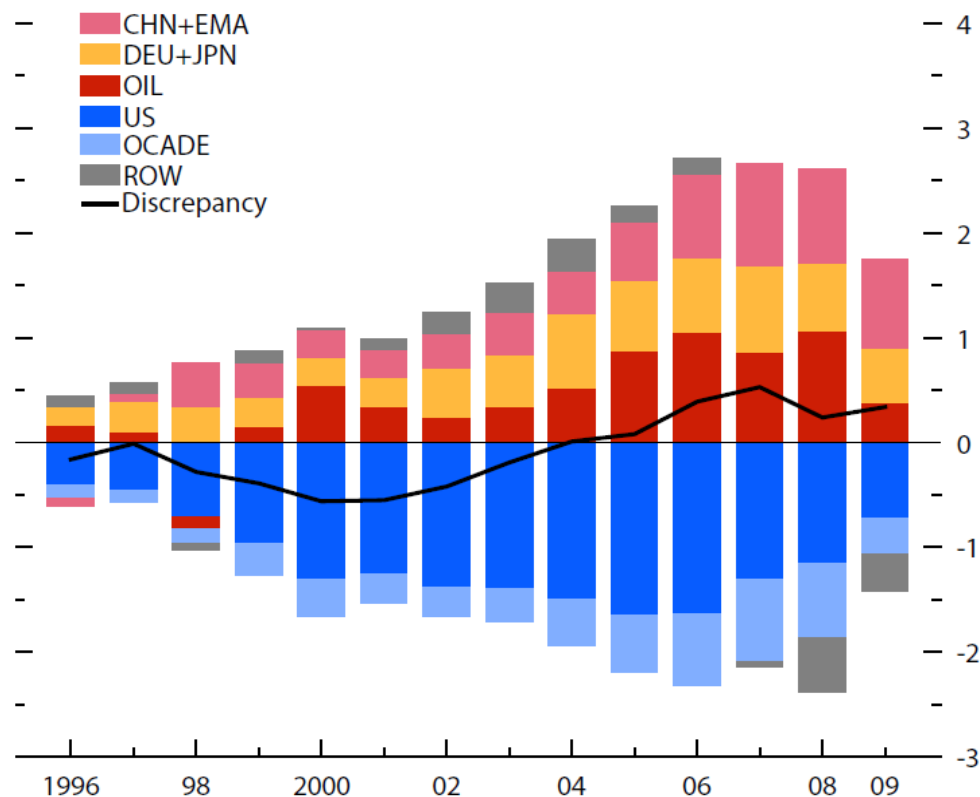
General Government Public Debt (percentage of GDP)



Source: IMF, *World Economic Outlook*, April 2010.

- **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.**
- **Current accounts imbalances may become a source for financing long-term initiatives, if they reflect increased financial integration and more efficient allocation of global savings.**

Global Imbalances: Current Account Balance in Percent of World GDP[1]

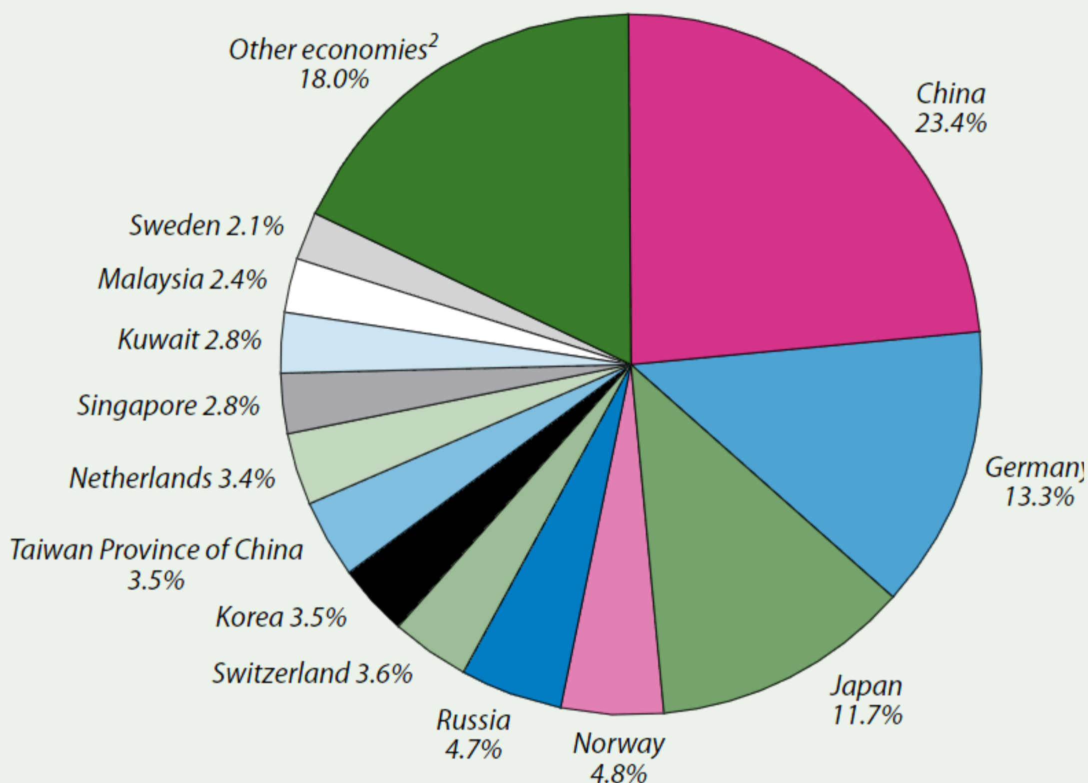


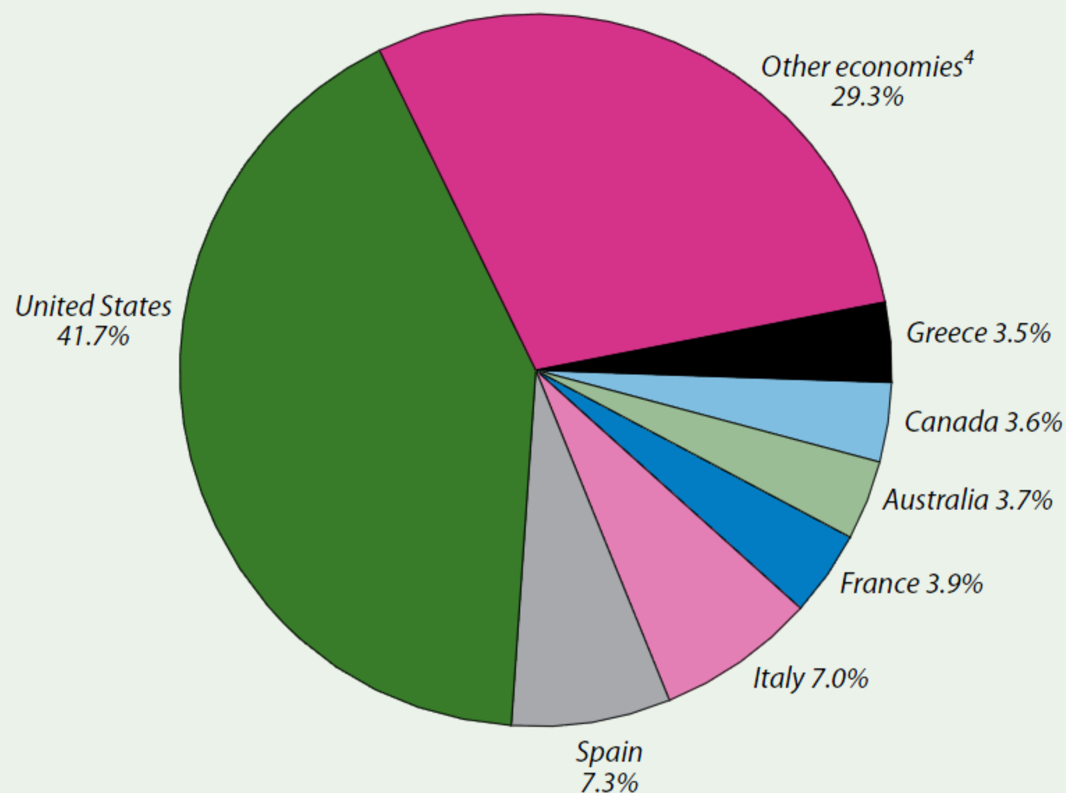
Source: IMF staff calculations.
[1]CHN+EMA: China, Hong Kong SAR, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan Province of China, Thailand; DEU+JPN: Germany and Japan; OIL: Oil exporters; US: United States; OCADE: other current-account-deficit economies; ROW: rest of the world.

Source: IMF, *World Economic Outlook*, April 2010.

- **Europe should therefore enact policies to attract capitals from the private sector and from extra European countries that have balance surplus and low public debt (such as China, Singapore, Russia, India, Brazil, Mexico, etc.).**

Major Net Exporters and Importers of Capital in 2009





Source: IMF, World Economic Outlook database as of March 10, 2010.
[1]As measured by economies' current account surplus (assuming errors and omissions are part of the capital and financial accounts).
[2]Other economies include all economies with shares of total surplus less than 2.1 percent.
[3]As measured by economies' current account deficit (assuming errors and omissions are part of the capital and financial accounts).
[4]Other economies include all economies with shares of total deficit less than 3.5 percent.

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- **To attract capitals and to support long-term investments, public and private sector must work together to build new forms of complementarities.**
- **New rules and incentives for PPPs and PFIs and new EU endorsed financial instruments should be introduced.**
- **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;

  iii) take into account the value of future cash flow over the long-term.

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

- **Regarding the European new financial instruments, the first examples are the '*2020 European Fund for Energy, Climate Change and Infrastructure*' (Marguerite) and the *Inframed Fund*.**
- **EIB, KfW, CDC,CDP, ICO, PKO and the EU Commission are the core founders of Marguerite Fund. CDC,CDP, EIB, Hermes (Egypt) and CDG (Morocco) are the core founders of Inframed Fund.**
- **Other common financial instruments should be considered, such as Project Bonds, Eurobonds and Guarantee Schemes.**

To conclude:

financing EU long-term investments will

- **create value for next generations,**
- **give a contribution to restore fiscal stability,**
- **and strengthen economic growth.**

Thank you.