The Long-Term Investments in the Age of Globalisation

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The economic and financial crisis of the past two years has left Europe in a tight spot, with high levels of public debt. Financial markets have fired the first warning shots that this position is unsustainable and adjustment is required. Governments everywhere are facing hard choices about structural reform of public spending and tax systems in full knowledge that tight fiscal policies will almost inevitably weigh on growth, making the required adjustments even more challenging. There is a risk that investment will be cut. To do so would in our view be a mistake.

Sustaining long-term growth should be the top priority of European policy makers. To achieve this, increased investment in strategic sectors is needed. There remains huge demand in Europe for infrastructure over the coming decades. Major investment in the fields of innovation, renewable energy, water networks, telecommunications and sustainable transport systems are all required to cope with Europe's environmental challenges, rapid urbanisation and to maintain European competitiveness.

Over the long term, spending on public infrastructure has a positive impact on the growth rate of productivity. These are all sectors which themselves may also yield more immediate returns by stimulating follow-on investment and, as a result, growth and jobs. Their annual contribution to growth could be substantial. Moreover, these kinds of investments can play a central role in shifting European growth from a carbon-intensive "consumer goods intensive" model to a "public and common goods intensive" one, characterised by reduced CO_2 emissions.

The most desirable solution to reduce public debt and restore fiscal stability is to increase the average growth rate. Europe should therefore strive to stimulate growth by channelling major flows of long-term capital towards investments with strong positive externalities for the economic system and social cohesion.

But where do we get the resources to finance ambitious regional and cross-border programmes of long term investment? The increase in government deficits caused by the recent crisis and the need for an exit strategy imply that government spending cannot, under actual macroeconomic conditions, provide the desired level of investment. However, several European countries have high household savings rates. These should be seen as an asset. Moreover, there is growing demand globally for long term financial instruments with low risk/yield profiles from pension funds, insurance companies and sovereign wealth funds. All these sources of capital could be tapped to finance European strategic investments, easing the burden on public budgets.

Some of the aforementioned targets can be achieved by developing European long-term equity funds, such as the EU 2020 "Marguerite Fund" launched by six public policy banks, including our own institutions, last year. Other instruments, such as project bonds and new guarantee mechanisms, deserve study. However, the European legal framework itself needs to be adapted in order to better promote long term investment. Requirements include new prudential and accounting norms, more incentives for Private Public Partnerships (PPPs) and project financing initiatives – as set out by former commissioner Mario Monti in his report on a new strategy and direction for the EU's single market. In our view, these suggestions should be developed within the framework of the "Europe 2020" strategy for smart, sustainable and inclusive growth, due to be endorsed by European Union leaders tomorrow [June 17].

The short-termism that characterised recent global capitalism induced negative effects on the real economy and global financial system. So-called "shareholder value" capitalism created strong incentives to maximise short-term, rather than long-term, value. Moreover, the "mark to market" accounting rules, also applied to typical long-term investors, such as pension funds, insurance companies, sovereign wealth funds and development banks, did not permit any distinction between short-term and long-term investment values in balance sheets. Regulatory and accounting experts are now trying to introduce accounting criteria that distinguish between different temporal durations/matching liabilities and investments, as proposed by the European Commission following the De Larosière report. Appropriate accounting rules for long-term investors would make a substantial contribution towards stabilising global financial markets and reducing short-term volatility.

For this reason, our four institutions last year founded the Long Term Investors Club. Its second annual conference tomorrow [June 17] in Rome aims to help foster this new vision of long term growth with the help of prominent experts, investors and national and international policy-makers. We look forward to a vibrant exchange of views on the need to increase long term investments for strong, balanced and sustainable global growth with our counterparts from around the world.