Astrid Foundation and Cassa Depositi e Prestiti

Equity for Infrastructures

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Introductory Remarks

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As you well know, the world will soon encounter a potentially enormous wave of capital investment. In mature countries, there is a pressing need to finance innovation, environmental programs, infrastructure as well as to prepare for the consequences of an ageing population; in developing countries, the income per capita catching up process is requiring vast investments in infrastructure (transportation, TLC, energy…). Advanced economies will also need to increase their share of long-term investment to exit the crisis, to reinforce their growth rates and competitiveness on global markets and to ensure public debt sustainability (successful fiscal long-term consolidation requires both stricter fiscal policy and more economic growth). Investment in strategic sectors – like infrastructures, but also research and technological innovation, environment, alternative energy, biotechnologies – could foster economic growth and enhance competitiveness and productivity. These are all sectors which themselves may yield high investment returns, stimulate follow-on investment and, as a result, create growth and jobs. Furthermore, these kinds of investments should play a central role in shifting European growth, increasing the quota based on "public and common goods" (which generally reduce CO2 emissions) and decreasing the quota produced by "consumer goods" (which generally increase CO2 emissions).

In fact, the demand for infrastructure, energy, climate change, strategic and urban infrastructure in Europe is very large. It is estimated at over 3 trillion euro in the next ten years (1,6 trillion only for the projects related to the Agenda 2020).

But, in many advances countries, government spending cannot, under actual macroeconomic conditions, provide the desired level of investment. It is clear that the European countries (with few exceptions) will not be able to finance such investments mainly with their own budget resources as high growth and low public debt countries (such as China, Korea, Russia, Australia) can do (and decided to do). In Europe, the effects of the crisis on investment in infrastructure is already quite severe. In Italy, for example, Istat estimated that public spending for infrastructures in 2010 has been lower by over 18 per cent over 2009.

So, Europe needs to raise (to attract) capital from the private sector and from extra European public and private sectors for financing European strategic investments. It is essential that PPP and PF take a much wider role than before, replacing public direct investments.

But, where do we get the resources to finance such ambitious regional and cross-border programs of long term strategic investments? The effects of the credit crunch and the need to increase their capital base could drive banks into the more profitable – often short term - market segments. The new Basel III capital requirements and liquidity will probably discourage long term banking and financial initiatives. Moreover, the IASB mark-to-market philosophy is particularly damaging for long term investments, attributing instant market values to assets the value of which is by essence based on several years.

Large institutional investors, such as insurance companies and pension funds, are potential recipients of financial instruments for large initiatives in project financing. With assets estimated at 50/60 trillion dollars, they may represent huge players in financing growth stimulating investments. But the IASB and the Solvency II Directive discourage insurance companies and pension funds from holding infrastructural assets, not allowing for a proper matching of long term liabilities and assets on their balance sheets.

The risk of a capital crunch and particularly of an equity crunch for LTI in infrastructures is very serious.

That's why CDP - along with other public financial institutions gathered in the Long Term Investors Club – initiated a major action of reflection, proposal and lobbying for promoting a new regulatory framework and new financial instruments better able to attract

capital in investing and financing LTI. We think that durable and sustainable growth requires financial stability and a long term fiscal consolidation; but we think that the financial stability too, and fiscal consolidation too require a durable and sustainable growth. We think then that policy makers and international regulators around the world should work not only to assure financial stability, prevent global crisis and “level the playing field” to allow for fair global competition on the markets of global savings; but they should work on creating a regulatory framework that enable managers of financial institutions to focus more on long-term rather than short-term results, and more on investments with significant positive externalities for growth than on financial short-term investment.

Today, the regulatory setting is most often providing negative incentives to LTI and to long term oriented investors. A set of short term oriented incentives is related to the combination of the prudential and accounting systems. Accounting rules that are appropriate for investment banks and trading activities are less relevant and sometimes penalising for holding LTI.

So, since the beginning of the crisis the LTIs Club, in many occasions, has posed these questions to policy makers and international organizations. During 2009 at the Paris Conference, at Eurofi Financial Forum held in Goteborg, in 2010 and 2011 at the Eurofi Financial Forums in Brussels and Paris, in the two conferences organized by CDP, the LTIC and the OECD in Rome and in Venice, and by a working paper presented to the EU Commissioner Michel Barnier in September 2010. And, last but not least, with an active participation in the preparatory work of the de Larosiére’s and Mario Monti Reports.

At the European political level, the need of a new regulatory framework, more favourable to LTI, has been strongly emphasized by the European Commission in the Communications on A New Single Market Act, on A Comprehensive European international investment policy, and on The EU Budget Review, and, few days ago, by the European Council. In fact, without a substantial increase in investment in infrastructure, energy, environment, innovation and research, and therefore without major changes in prudential, accounting and tax regulations, the objectives set in

the EU 2020 strategy and in the Mario Monti Report could hardly be achieved.

With international, European and national better regulation and accounting standards for project financing initiatives, with new guarantees schemes by large national and European development banks, with, perhaps, some fiscal incentives, private capital may become a substitute for the lack of public money; and financing infrastructures may become more attractive for global markets and for national and global saving.

There is also a need to develop new European long term financial instruments such as long term equity funds, project bonds, and more generally, credit enhancing mechanisms to lower the risk and decrease the cost of long term initiatives in strategic sectors such infrastructure, energy and technology. EIB and European large national development banks or public financial institutions , under the supervision of the European Commission and of Member States Governments could play a crucial role. By supporting the market offering financial products with long term maturities and non speculative returns, these financial players may become one of the key instrument of the new post-crisis European economic and industrial policy model and strategy. Their reputation and technical skills may have an important credit-enhancing effect on the instruments needed to finance the demand for strategic investments in Europe.

To stimulate investments in equity, however, best practices in PPP and PFI are needed, too. Reports have shown that private and foreign investment in PPP and PFIs also requires a good and stable regulatory framework, with sustainable regulatory and bureaucratic costs, an efficient and technically skilled public administration and government services, and a reliable judicial system. In many European Countries, better regulation is the first requirement for attracting private and private/public foreign investment. A common framework may then be very important to reduce regulatory and non-financial risk.

In this scenario the role of equity in financing infrastructure is becoming crucial. The lack or the reduced availability of public

grant funding will increase the need for private equity. We need today, and will need even more tomorrow, more and better equity for infrastructure. We need today, and will need even more tomorrow, more and braver private equity investors for infrastructure.