Franco Bassanini

Long-term investment: the need of a new regulatory framework[1]

The world will soon encounter a potentially enormous wave of capital investment a result substantially fuelled by emerging economies. Within upcoming decades, two thirds of the world's population is expected to enter a phase akin to that of post-war reconstruction in Europe and Japan. Such investment boom will represent a huge challenge for the future of world economy. 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 reduce public debt (fiscal long-term consolidation requires both stricter fiscal policy and more economic growth). World economy will experience a growing demand for capital to invest, while the supply of savings may not keep up with demand, due to demographic reasons.

In general, the world may be entering a new era in which competition among (national and regional) instruments to finance investments will get tougher. Policy makers around the world should work not only to "level the playing field" to allow for fair global competition on the markets of global savings; but they should work on creating a regulatory and international accounting framework that enable managers of financial institutions to focus more on long-term rather than short-term results, and more on investments with

[1] To be published in *Eurofi Newsletter*, February 2011.

significant positive externalities for growth than on financial short-term investment.

What should Europe do in this changing scenario? As a regional economy Europe should work to increase its own potential leverage on global markets by moving in two directions: develop new euro-denominated long-term financial instruments (such as EU long-term equity funds and project bonds); and create a common regulatory framework favourable to long-term savings or/and investment in infrastructure, environment, renewable energy, innovation and R&D (LTI), including new regulatory and accounting standards, fiscal incentives, better regulation and best practices for PFIs and PPPs and for corporate governance. At the European political level, the need of a new regulatory framework, more favourable to LTI, has been strongly emphasized by the European Commission, following the De Larosière and the Monti Reports, in the recent Communications on *A New Single Market Act*, on *European investment policy*, and on *The EU Budget Revie*w. This is very important, although we do not see, for now, any coherent follow up.

However, critics argue that the EU has no powers to decide in this matter, requiring specifically the introduction of some exceptions and additions to the set of rules laid down by Basel III and the IAS 39. But the rules of Basel III will be implemented in Europe by a EU directive (CRD IV) and Solvency II is itself an European directive. As for the IAS, though they are defined by an independent NGO (the IASB), they can be effective only if they are recalled by the EU and MS legislation. So the EU institutions have in fact some power to influence and even to negotiate with the IASB less penalizing rules for LTI and to enact better rules for insurance companies and pension funds through changes to Solvency II.

As for Basel III, in principle, the EU is not obliged to transpose the Basel rules mechanically, but could provide for exceptions and integrations, as the U.S. did for Basel I and II. However, strong political and practical reasons suggest not to reopen the Pandora's box of Basel III. But an additional or integrative protocol could perhaps be envisaged, that, without changing the Basel III rules as regards banks, could integrate and refine them in respect of long-term investors. *Stricto jure*, in fact, the rules of Basel III apply to banks, but do not apply to long-term investors such public savings and development banks (like EIB, CDC, CDP, KfW), SWF's, pension funds etc. But, *de facto* and by default, the same rules are frequently applied by the markets to these investors, dramatically reducing their firepower in the financing of LTI. There is good reason to fill the void, with an integrative protocol to Basel III establishing special rules adapted to the specific mission and business model of these institutions, that are potentially huge players for LTI. There is also good reason and growing consensus to modify Solvency II in order to take advantage of the long-term assets and liabilities 0f insurance companies and pension funds.

These long-term investors are by far the largest collectors of savings in the global market with assets estimated at over 60 trillion dollars. If only a few percentage points of their portfolios were to be invested in long term initiatives, it would constitute a potentially massive amount of money for financing growth-stimulating investments.