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New European Institutional Long Term Financial Instruments for a Strong, Sustainable and Balanced Global Growth

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ABSTRACT

The World Bank estimates that in the next two decades around 40 billion a year will have to be invested in new infrastructure in Europe. Another 40 billion per year will be necessary for maintenance and replacement investments. The main focus will be on electricity generation and networks, gas pipelines, climate change, telecommunications and transport. Moreover, in the Conclusions of the Pittsburgh G-20 Summit, the Heads of States called for a coordinated global action to tackle problems such as energy, infrastructure and climate change in order to achieve a strong, sustainable and balanced global growth. Then it called the World Bank and the regional development banks to give a contributions to financing the transition to a green economy through investment in sustainable clean energy generation and use, energy efficiency and climate resilience. The EU can play a central role in this process enacting policies to support its long term investments. The 20/20/20 and the TENs goals will require great amount of financing in the next years. The state of European public finance, however, is under unprecedented stress. In the short term, public budgets will have to face the cost of public interventions in the financial systems and the negative effects of the recession. In the longer term, the cost of social expenditures, especially in pensions and health systems, in a society which is experiencing a rapid shift towards an older population, will put an heavy burden on the European fiscal framework. With a public debt to GDP ratio getting close to 100% by 2014 (for the euro area in the aggregate), European Governments will find more and more difficult to find the necessary resources to finance its huge needs for long term strategic investments, and moreover to increase the EU “own resources” for financing European strategic investments.

That is why the European Union has to enact policies that can contribute to maximize the potential for attracting long term private savings from advanced countries and public and private savings from emerging economies. Euro is a strong currency and

the fiscal policy framework designed by the Stability and Growth Pact has delivered important results in terms of sustainable public finances and monetary policies safeguard price stability.

The policy framework has been useful but it is not sufficient. It is time to cash in the credibility dividend and to spend it on growth enhancing initiatives. Increase leverage of financing instruments by more effective combination with EU budgetary funds and guarantees. Increase leverage of financial instruments by wider co-financing with capital, banking and insurance markets. Greater use of long term institutional investors such as the “Marguerite Network” – that Group of European Long Term Institutions (CDC, CDP, KfW, and other similar EU institutions) which gathered together, under the guidance of the European Commission and of the EIB, with the task of proposing further coordinated action with a focus on new financing instruments in equity, debt, and guarantee schemes, for Energy and Infrastructure projects. But also new instruments like Eurobonds and European projects bonds. The *vexata quaestio* of an European sovereign public debt for financing growth, reinforcing the political process of unification, and contributing to a more stabilized and balanced global financial and monetary system must now find a solution, as one of the main issues of a successful exit strategy.

Introduction

In order to recover from the crisis and to build a strong, sustainable and balanced framework for global growth, according to the recent new guidelines given by Pittsburgh's G-20, Europe may give its contribution by increasing its level of long term investments.

The issue of long term investments is, in fact, one of the most relevant keys for the future of Europe, as well as for the future of world economy. It may play a positive role for the financial markets' stability. Moreover, it is crucial for long term planning of economic and social systems.

A long term policy is needed for facing the great long term challenges of our society, including demographic change, scarcity of natural resources, environment protection and climate change, growing poverty worldwide, immigration, education and research. A long term policy framework must be based on strategic public and private/public investments in infrastructure, energy, environment, TLC (NGN), R&D and human capital, and must promote and favour those projects which have strong positive externalities for the economy as a whole, and for human well-being and social cohesion.

The state of European public finance, however, is under unprecedented stress. In the short term, public budgets will have to face the cost of public interventions in the financial systems and the negative effects of the recession. In the longer term, the cost of social expenditures, especially in pensions and health systems, in a society which is

experiencing a rapid shift towards an older population, will put an heavy burden on the European fiscal framework.

With a public debt to GDP ratio getting close to 100% by 2014 (for the euro area in the aggregate), European Governments will find more and more difficult to find the necessary resources to finance its huge needs for long term strategic investments in energy, climate change and infrastructure. That is why, we will argue, the European Union has to enact policies that will contribute to maximize the potential for attracting long term private savings, not only from advanced, but also from emerging economies.

On the other side, the emerging economies, because of their low level of public debts and of social public expenditures, due to their strong growth rates and young population, will probably become net exporters of long term financial flows. Moreover, there is a growing potential of capitals coming from SWFs, especially from the Gulf region. These flows could be intercepted by the European Union. Therefore, in order to maximize the inflow of long term capital from the global financial markets, we suggest that EU increase its action to develop new European institutional financial long term instruments.

The Short Termism and the Crisis

The short-termism that characterized recently global capitalism has had very negative effects on the economy and on the financial global system and it is partly responsible for the present crisis. Its origin maybe traced back to a few well known factors.

Firstly, to the corporate governance model of the so-called “shareholders’ capitalism”. Such a model places the maximization value of the shares at the centre of the stage, even before the industrial or social value of the firm. The model of the firm is conceived as a mere “nexus of contracts”. The management is contractually linked only to the shareholders and not to the workers, or to the stakeholders or, more generally, to the industrial future of the firm. The firm becomes then an abstract concept, and not a “community” or an “organism”, as it was conceived in other past traditions, notably, in Continental Europe or in Japan and Korea. The managers of the firm are “winners” if they maximize the value of the shares, which is directly related to generous bonuses and stock options. This mechanism has created strong incentives to maximize short term, rather than long term, value.

Secondly, short-termism is related to the great liquidity and the low cost of money which has characterized the global financial markets in the recent past. The excess of

unregulated liquidity originated in the 1970s with the birth of the petrodollar. Since then it has given a great contribution to the diffused and strong growth experienced in the global economy in the last decade. More recently, coupled with deregulation of financial markets and institutions, it has exacerbated arbitrage and short term speculation.

Thirdly: before market deregulation, the Western financial system was based on the strict institutional partition between “banking” and “securities”. Socio-economic evolution and technological innovation have favoured the legal breaking up of market segmentation and the creation of financial conglomerates and giant financial institutions. The rationale of segmentation was based on the sound concept that risks are structurally different, requiring thus different institutions and different know-how. Banks manage credit and interest bearing instruments, securities’ firms deal mostly with market risk. Deregulation brought typical “banking risks” into “objectified capital markets”. Then, with the creation and the exceptional growth of the CDSs (Credit Default Securities) markets, it multiplied individual banking risks, creating the disastrous situation which we are in now. An excess of “temporal arbitration” (short versus long) and the end of specialization (the substitution of market-oriented over bank-oriented systems) are then both part of the problems which emerged with the recent financial meltdown (and meanwhile part of the solutions).

The New Long Term and Low Risk Profile of Investors

Given the rapid changes our societies are undergoing, the need for long-sightedness is now more urgent than ever. For example, for the first time, more than half of the world’s population lives in cities. At the same time, the alarming pace of climate change requires massive spending to move to a low carbon energy economy.

The implementation of long-term global objectives, such as infrastructure building and fighting climate change is a necessity, as well as an opportunity. Shifting to a low-carbon economy, coping with the scarcity of natural resources or adapting to demographic growth and rapid urbanisation, will require major investments in the fields of innovation, renewable energies, water networks, urban telecommunication and transport infrastructures. These are all sectors which can yield high investment returns, stimulate follow-on investment and, as a result, create growth and jobs.

In the meanwhile, the crisis is changing the risk profile of investors. We will probably have a growing demand for long term and low risk investments products from

large pension funds, insurance companies, SWFs and, in general, households. On the other hand we will have – as above remarked - a growing demand for infrastructures. The match between demand for long term and low risk investments and financing of long term strategic infrastructures, with stable cash flows and institutional endorsement, maybe a very sound and promising way out from the crisis. It will support the huge demand for financing infrastructures and it will probably give a contribution to the global financial markets' long term stabilization.

The Role of Long Term Investments

Long-Term Investors can be defined as financial institutions that invest in markets on which they anticipate long-term trends can offset short-term price volatility. The key to determining who these long-term investors are lies in whether or not their asset allocation is restricted in any way by short-term liabilities. Thus, long-term investment offers the benefit of ensuring a stable financial presence within businesses or infrastructure projects. It also represents the appropriate counterpart to long tail insurance risks and to pension liabilities.

Therefore, long-term investors send a signal of confidence in the long-term structural profitability of markets and can counterbalance pro-cyclical effects of short-termist behaviours, as : (1) they are prepared to accept risks that short-term investors are unwilling to take. They are, for example, in a position to finance infrastructures, the profitability of which can only be measured over a very long period, but which is essential for sustainable growth; (2) they can retain their holdings during crisis and therefore adopt a counter-cyclical approach, as they are in a capacity to smooth their gains and losses over time and publish high quality long-term oriented information.

The Financial Institutions which may be “eligible” to be considered as Long Term Investors are, first of all, the institutions owned by public, semi-public or non-profit entities (States, Local Authorities, Banking Foundations, and the like): they do not seek speculative IRR or strong capital gains (also thank to the structure of their balance sheets which enable them to retain assets in their portfolios in times of crisis thus playing a counter-cyclical role in the financial markets); they are able to spread risks between generations; and finally have, generally, a clear social responsibility in their missions. This allows them to “accept” non speculative returns on their investments, as well as the

illness and the capacity to keep in their books long term assets and liabilities. Other institutional financial investors, such as large pension funds, insurance companies, Italian Banking Foundations, non-profit institutions, development banks and SWFs, may also be considered Long Term Investors if they decide to allocate some or most of their assets in that same type of investments.

The emergence of a strong group of long term investors may be the best ally of world policy makers in correcting the unbalances due to the crisis, restoring economic stability and value creation for future generations, counterbalancing short-term behaviours and financing recovery policies. This issue is especially important for Europe. If Europe wants to be a winner in the new "global competitive order" it needs to position itself, always, in the "highest part of value chain of products". In order to achieve such an objective, it needs a strong policy of investments with long term horizons. Only with such a vision in mind Europe may aim to become the most advanced Community in the world in terms of civilization, which includes infrastructures, culture, science, education, social welfare and environment.

The Reforms Needed in Governance, Accounting and Prudential Rules for Long Term Investors¹

For strengthening the contribution of Long Term Investors a new regulatory framework is needed, including ad hoc systems of incentives, in the accounting standards, prudential principles, taxation systems and corporate governance, as proposed by the de Larosière Group *Report on Financial Regulation and Supervision*, suggested by Angela Merkel and Nicholas Sarkozy in a joint editorial some months ago, and decided by the G8 Summit of L'Aquila. From a general policy point of view, we may even think of introducing special fiscal incentives for financial products and for firms which invest in the long term initiatives of general national or European public interest, on the lines of the fiscal incentives granted to the US Project Bonds recently launched by the American Administration Stimulus Plan, as we shall discuss later.

¹ The analysis and recommendations contained in this section are taken from a common work elaborated by French CDC and Italian CDP as a common contribution to the *de Larosière Report* and to the Aquila G-8 and the Pittsburgh G-20 summits.

Accounting rules should be adapted in order to make it possible to value a long-term investment based on a weighting for its market value, while also taking into account the value of its future cash flow over the long term. These should, at least, reflect long-term investors specific business model.

Developing a regulation that would restore a clearer segmentation of financial risks, which could contribute to decrease temporal arbitrage (and short termist behaviour) fostering a more identifiable and stable match between long term assets and liabilities.

Specific prudential rules should guarantee that the liabilities will be honoured when they reach maturity and also that the long investment horizon is suitably protected against the various contingencies linked to the liabilities: massive unexpected withdrawals, drying up of sources of financing on the relevant maturities, etc.

At the same time, governance rules would ensure that dedicated decision making processes are put in place for long-term investments, protecting them against short-term influences, whether they come from management or shareholders. Indeed, « shareholders' value » model of corporate governance, as we have seen above, via such incentives as stock options mechanism, and strategic choices made by the firm's management foster short termist behaviour.

More generally, international frameworks regarding investments should foster investments aimed at implementing global long-term objectives, promote public-private partnerships involving international and regional organisations and prevent protectionist behaviours.

The accounting and prudential treatment of financial assets giving priority to their marked to market value is standing in the way of long-term investment. Not only is long term investment not enough promoted, but current rules incite Long Term Investors to adopt short termist behaviours.

Due to the mark to market rule, the contingencies affecting the value of these investments over the short term are having repercussions over time on the financial statements - higher earnings volatility and additional solvency requirements -, although the actual horizon for these investments goes beyond that for the publication of the accounts.

In light of this upheaval, certain long-term investors are adopting behaviours that go against their specific characteristics, such as selling off positions when the markets fall. Moreover other financial players may reduce in such context their long term liabilities. At the same time, these regulations do not factor in the stability of the liabilities at all, or only

slightly, whereas it would be wise to encourage investors to have stable resources, guaranteeing protection against forced sale practices, notably when principals push for assets to be realised early, which would be more damaging over the long term than the gain taken out over the short term.

These situations can be seen whatever the nature of the institution carrying this type of investment: sovereign funds, state-owned financial institutions, certain pension funds and insurance firms.

The Investments needs for Energy, Climate Change and Infrastructure in the EU

The investment needs for the EU infrastructure are huge. Investments in energy, climate change and transport are going to attract the largest quotas of long term investments in the next future.

The World Bank estimates that in the next two decades around 40 billion a year will have to be invested in new infrastructure in Europe. Another 40 billion per year will be necessary for maintenance and replacement investments. The main focus will be on electricity generation, , climate change, telecommunications and transport.

The Commission has estimated that in regard to energy infrastructure the EU will have to invest, in order to achieve the 2020 strategic objectives, around 2,5 trillion Euro. Electricity transmission, gas pipelines and for Liquefied Natural Gas (LNG) terminals, are essential to fully address the priorities of the trans-European Energy Network (TEN-E) . Connecting more electricity generated from renewable sources will also require very large investments.

Concerning transport, the overall cost of the trans-European Transport Network (TEN-T) still needs to be invested by 2020 is in the order of 500 billion. The cost estimates of priority projects alone are set at around 270 billion.

Extensive and efficient infrastructure is critical for ensuring the effective functioning of an economy. Both energy and transport are important components in tackling climate change. According to recent studies, the total cost to the EU of meeting long term climate change goals may be more than 50 billion per year over the next forty years. While the private sector is expected to play an important role in this large investment programme, public support is also needed to stimulate such investment especially in the current situation.

Financial Instruments and the Effects of the Financial Crisis

The enormous investment needs have to be seen against the background of the current economic environment. After years of strong growth, the world economy is quickly decelerating. Global activity is being buffeted by an extraordinary financial shock and by highly volatile energy and other commodity prices. Many advanced economies are in recession, while growth in emerging economies is also weakening. The world economy has entered a major downturn in the face of one of the most significant financial shocks in mature financial markets since the 1930s.

In response to intensifying solvency concerns of major U.S. and European financial institutions, the authorities have taken extraordinary measures aimed at stabilizing markets. However, the situation remains highly uncertain and subject to considerable downside risks. Looking ahead, financial conditions are likely to remain very difficult, restraining global growth prospects.

Currently, traditional sources of senior debt for infrastructure and energy investments are still severely constrained. The capital markets provide little senior debt to these sectors due to practically no new transactions underwritten by the monolines insurers and low investor appetite for non-guaranteed project bonds. Also, obtaining bank funding is currently particularly challenging due to significant liquidity and capital constraints of the major banking groups, a low volume of syndications and continuous reductions of the average amount each bank is able to commit per transaction.

As a result of the current crisis, financial institutions have become much more risk averse. At the same time, the leveraged financing structures particularly in less well established sectors such as the strategic energy and climate change investments may have to be re-balanced resulting in needs for further significant equity investments.

Fiscal Implications of the Global Economic and Financial Crisis

The global financial crisis is having major implications for the public finances of most countries. The public debt to GDP ratio of G-20 advanced countries, which amounts to more than 80% of the world GDP, are projected to reach, according to recent IMF estimates, 120% by 2014. Without appropriate exit strategies and recovery policies, such an already very high level could grow up even further in the following decades.

If public debts in advanced economy are already high and are projected to grow even further, emerging countries fare much better. Among advanced economies the ones with a higher growing debt to GDP ratios are: Japan (from 217% of 2009 to 234% of 2014), Italy (from 115,3% to 123,4%), the USA (from 87% to 106,7%), Germany (from 79,4% to 91%), France (from 74,9% to 89,7%) and the UK (from 62,7% to 87,8%). Among emerging countries the ratios are much lower and decreasing: China (from 19,8% to 17,6%), Brazil (from 65,4% to 54,1%), India (from 86,8% to 76,8%), Mexico (from 46,9% to 44%) and Russia (from 6,9% to 7,4%).

The growth of public debt is due to the combined effects of the costs of public interventions to face the crisis and of the negative GDP growth. The high levels of public debts may last even after the crisis due to the estimated growth of public expenditures, especially in pensions and health systems. The demographic pressures, in fact, will place a strong burden on the future of Western public budgets. To reduce the public debts the United States, Europe and Japan, should reform their economic and social systems, in order to boost growth rates. However, demographic structural constraints and the long run effects of the financial crisis, may keep GDP growth rates at low levels for some time, making much more difficult to reduce high public debts' levels.

Emerging economies, on the other hand, have low levels of public debts and with a young population the pressure on social expenditures is much lower than in the ones experienced by old Western countries. Moreover, emerging economies are experiencing, on average, strong growing rates of savings' stocks and financial assets from households, financial institutions and firms. With the potential expansion of middle income population in countries such as India, China, Russia, Brazil, and Mexico ever larger flows of financial assets will be channelled from the emerging to the advanced world. Moreover, with the raising growth will also increase their needs for investments in infrastructure and in R&D. So, if on the one hand they will become exporter of capitals, on the other hand they will become importer of technology and know how for infrastructural initiatives.

Europe should be prepared to attract the flows of capital by offering reliable and institutional long term financial products, such as those used to finance European infrastructure and energy investments. At the same time should be ready to offer technology and know how to support their development needs. Only by enacting a two ways policy with these regions, Europe can become strong in the competitive scenario which will characterize the future of world economy, that is by a proactive collaborative

cooperation approach with regions with which we are going to share the future of our planet.

Finally, global institutional investors, such as Pension Funds and Insurance Companies, are seeking for long term and low risk investments. Large EU infrastructural projects with stable cash flow and strong institutional commitments have such characteristics. European initiatives for long term investments in energy and infrastructure financed by long term European financial institutions may be able to attract funds in the global financial arena.

These factors together will make it significantly challenging to get some of the larger projects off the ground, unless substantial equity, private corporate and public sector support is put in place particularly to support emerging energy technologies, the implementation of 20/20/20 objectives and TEN projects. As it is expected that the infrastructure and energy sectors will remain an attractive asset class for the banks and capital market investors, it appears that what the markets particularly need is start-up financing both in the form of equity and of debt.

One initiatives which we believe as great potentials in attracting long term financing from global markets is setting up of the so-called Marguerite Network. Such Network may take coordinated action on different number of financial products for financing of infrastructure in Europe.

The Marguerite Network

We will refer to the “Marguerite Network” as to that Group of European Long Term Institutions which gathered together, under the guidance of the European Commission and of the EIB, with the task of proposing further coordinated action with a focus on new financing instruments for Energy and Infrastructure projects. As you know, the initiative was launched after the Nice informal ECOFIN Council held in September 2008 and was approved by the European Council of December 2008. The institutions involved in the first phase (together with the European Commission and the EIB) were Caisse des Dépôts et Consignations (CDC), Cassa Depositi e Prestiti (CDP) and Kreditanstalt für Wiederaufbau (KfW). Others have recently announced that are ready to join the initiative.

Its first result is the proposal for an Equity Fund – called Marguerite – to invest in Energy, Climate Change and Infrastructure. The Fund will be “market oriented” but it will be characterized by three main feature which would make it a quite “unique” instrument in

the European financial landscape of Private Equity Funds: (1) it will seek "non speculative returns"; (2) it will have Long Term horizon in its investments; and (3) it will have (*rectius*, has already had) an institutional endorsement by the European Commission.

A similar initiative in the area of the Union for the Mediterranean has been taken with the creation of the Equity Fund InfraMed, by a joint initiative of CDC and CDP.

The importance of the Marguerite Fund maybe seen as being the first "product" of this new "laboratory". If successful, it may become the first of a "Family of Sectorial Equity Funds" to support the "market" in financing the ambitious objectives of the Lisbon Agenda.

The Marguerite Working Group, however, has also been an occasion to explore other possible financial instruments and potential common initiatives. Among these I would like to briefly mention the so-called Project Bonds.

EU Project Bonds²

It has been recently observed, that financing infrastructure directly from the financial market by issuing bonds may be a more cost efficient alternative to debt financing. Transport and energy project bonds may be an interesting long term investment opportunity for institutional investors such as pension funds, insurance companies, SWFs, and households.

Individual project bonds may then be a sound and immediately implementable new form of financing of PFI Projects, in times where both debt and equity (and leverage) are severely constrained, especially after the collapse of the monoline insurers and the subsequent closure of the wrapped bond market in late 2007, which meant that bank debt became the only viable source of debt funding to PFI projects.

² On 25 September 2008 the Vice-President of the European Commission for Transport met the EIB President and Italian and Greek Vice-Presidents to discuss possible strategies to maximise the use of the EIB in financing large infrastructural transport projects. During the meeting the presidents agreed to create an informal working group consisting of representatives from the Vice-President's cabinet, officials from the European Commission's Directorate-General for Transport and Energy and the EIB with the aim of exploring the possibility of new instruments for the financing of TEN-T projects and to facilitate the participation of private investors. The proposals presented in the following two paragraphs draw much from the working paper produce by this group.

The Project Bonds may also be promoted by institutional long term investors or by similar institutions. The “reputation premium”, which may come from the EU endorsement and by the “high standing” of the long term institutions involved, as project promoters, may decrease the cost of financing, increase the credit ratings, creating an asset class which may attract large institutional investors (by matching their own liabilities – long term, fixed income) and, more generally, medium size European (retail) households’ savings. Moreover, thank to well prepared projects, financing could be contracted directly from the financial market, without a need to appear in the accounts of the Governments.³

Project bonds may be an interesting long term investment opportunity for institutional investors such as pension funds. In the past, some Member States proposed that the Commission should accept a higher ownership over TEN-T and TEN-E projects and to this end issue bonds at the EU level to increase the budget available to projects (so called Eurobonds). Such a solution, as we shall discuss later on, would need a change in the EC Treaty since it does not allow the Commission to borrow money on capital market. Amendments to the Treaty are based on a procedure which would need a quite substantial revision of the institutional architecture of the Union. This, however, should not be considered as an insurmountable obstacle.

Individual project bonds might be however a sound and immediately implementable European financial instrument. Such project bonds issued by project promoters are practically non-existent in the current market. This is mainly due to the difficulties that monolines experienced in recent times. A significant part of the project bond market before the financial crisis was “wrapped”, i.e. credit enhanced by a debt service guarantee issued by a triple-A rated monoline insurance company. Such wraps allowed institutional investors to get AA/AAA rated guarantees in an asset class that matched their own liabilities (long term, fixed income). Such institutional investors are potentially interested in infrastructure assets but, particularly when lacking specialist expertise in the sector, will not do so without AA/AAA credit enhancement.

³ If the financing is emitted by a “market unit”, even if 100% owned by the State or by another public sector entity, and if thank to a proper financing structure at least *two of the three risks* which characterize any large infrastructural project (construction, traffic and tariffs) are transferred to the market, then according to ESA-95 Accounting Principles, this debt is not included in the national consolidated public debt, valid for the respect of the criteria of the Maastricht Treaty and the Stability and Growth Pact (SGP).

There may be therefore an important role to play for the “Marguerite Network” to both provide guarantees and to advise and help project promoters prepare and issue such Project Bonds.

Guarantee Schemes

The Network could also provide debt service/deficiency guarantees to cover Project Bonds. Under existing authorisations guarantees are an alternative to loans and can be provided to cover similar risk profiles.

The Network guaranteed Project Bond would be issued by the project company. The debt service obligations of the project company would be guaranteed by Network. In other words the investors in such bonds would primarily assume the Network risk.

Projects where the Network would guarantee a capital market issue would need to have a strong investment grade profile, the project would need to have particularly significant construction package and a very stable revenue stream. Accordingly, the guarantee is more likely to be used in projects where the revenues are based on availability payments rather than usage of the asset and where the construction poses no particular technological complexities.

The proposed Project Bond structure has several advantages: (1) As a non-funded instrument it has limited impact on Network's own funding programme; (2) No crowding out effect, as opportunities both to bond investors and the providers of the other 50% of senior debt; (3) Follows a well-established model of wrapped bonds, which is a familiar structure to the relevant investor base; (4) Project benefits from Network's extensive monitoring and control of projects; (5) The Network would have the intercreditor votes of the bond holders thus simplifying the creditor control procedure; (6) Such bonds would attract investors because of the credit quality and the backing of a community institution; (7) During the times of the persisting uncertainty on the financial markets such bonds would be an interesting long term and safe investment opportunity for investment or pension funds; (8) Valuable involvement of the Network in the preparation phase of the bond issuing (i.e. expertise, due diligence).

The Network will endeavour to develop and test this project bond structure on a concrete project. Based on the success of such pilot project the Commission should explore options for contributing using the Budget Funds, if available following the revision of the budget, could usefully contribute to this structure on a Risk Sharing basis.

Finally, the Network could enhance the credit of projects or portfolios by providing a subordinated loan or guarantee senior debt. This size of this tranche would depend on the risk profile of the project/portfolio as the purpose is to uplift the credit profile of the higher ranking senior debt financing to A/AA/AAA, which establishes a range within which certain institutional investors would be interested to invest in the sector provided it is sufficiently attractive compared to alternatives.

Potentially a 10-20% Subordinated Tranche could be sufficient to allow the remaining senior debt to achieve the required strong Investment Grade rating for a capital market issue.

US Project Bonds

Also in the US, like in the European Union, the new Administration is attempting to combat a recession with an economic stimulus that includes a significant amount of investment in public infrastructures. The stimulus Plan provides the emission of new types of Project Bonds, with quite attractive fiscal incentives, directly on the net interest rate matured.

For example, “Recovery Zone Economic Development Bonds” must be used for public infrastructure projects or the construction of public facilities projects, job training/educational programs, and so on. The “Qualified Energy Conservation Bonds” devote an additional \$2.4 billion to projects related to the development of alternative fuels, like cellulosic ethanol and to retrofitting buildings to make them more energy efficient. The new stimulus package has also devoted funding, by way of special project bonds, to the development of the US railway system, and has created \$1.6 billion “New Clean Renewable Energy Bonds” to finance electricity generating projects using renewable sources, such as biomass and hydropower.

Eurobonds

The EU Project Bonds have the advantage of not using resources from public budgets. Also no much funds would be attached directly to the balance sheets of the long term institutions members of the Network. They would then be ideal to attract private long term investments. Moreover, the reputation of the members of the Network and their EU

institutional endorsement are functional to enhance the credit rating of the bonds which become an attractive asset class for global institutional investors.

Issuing Eurobonds, that is issuing European sovereign debt, is another possibility to create a class of European bonds which may be attractive to global investors. The rationale behind the Eurobond Proposal is well known. The European Union needs to attract, as much resources as possible, from the global markets to finance its strategic investments. Such investments are key to the making of Europe as one of the most advanced area of the world in terms of knowledge, technology, environment, culture, social cohesion and civilization. As we have already discussed, in the coming future, global markets are going to experience an impressive growth in the supply of financial assets from the emerging economies. There is going to be a competition among regions of the world to attract that investments. The USA, thank to the strength of the dollar, has been able to borrow from all other countries of the world, to finance its growth. Why Europe should not start to do the same?

If public debt is used to finance long term investments in infrastructure, then it should be able (to a large extent) to pay itself. This is known as the Golden Rule. This means that new European sovereign debt to finance fixed capital, and not current expenses, does not represent a burden on future generations.

Conclusions

In the medium and long term advanced economies will have to compete to attract investments from other regions of the world. Euro is a strong currency and the fiscal policy framework designed by the Stability and Growth Pact has delivered important results in terms of sustainable public finances and monetary policies safeguard price stability. The policy framework has been useful but is not sufficient.

It is time to cash in the credibility dividend and to spend it on growth enhancing initiatives. Increase leverage of financing instruments by more effective combination with EU budgetary funds and guarantees. Increase leverage of financial instruments by wider co-financing with capital, banking and insurance markets. Greater use of long term institutional investors and expertise in support of public authorities. But also new European public debt to finance growth and to reinforce the political process of unification.

The Maastricht Treaty promised a balanced and sustainable growth. It delivered instead a quite sluggish growth. Poor growth did not allow Europe to finance the necessary strategic investments that it planned to do; but the lack of these strategic investments and the connected failure in the Lisbon Agenda's implementation were in turn partly responsible for the poor growth performances.

The main reason of this fact may be found in the weakness of in the powers of the European Institutions (Parliament, Commission) and in the insufficient democratic legitimacy inherent in the EU decision-making processes. The Lisbon Treaty will allow to take some small but not insignificant steps forward in improving the democratic legitimacy by strengthening political powers of these institutions, vesting in the European Parliament, for the first time, a co-decision-making power in the European budget procedure. But the increase of the Union "own resources" remains an intergovernmental decision vested in the Council; and, in the present post-crisis financial condition of the Member States finances, it is highly improbable that the Council could decide an increase of the European own resources for financing common infrastructural investments.

For the European Parliament (and for the EU Commission), raising European Bonds and promoting European Investment Funds like Marguerite may be then, in the next years, the only way to do so: for financing great European infrastructural projects and giving the European contribution to a sustainable and balanced global growth.

In Pittsburgh Conclusions of the last G20 Summit, the Heads of States called for a coordinated global action to tackle problems such as climate change and food security. Then it called the World Bank and the regional development banks to give a contributions to financing the transition to a green economy through investment in sustainable clean energy generation and use, energy efficiency and climate resilience; this includes responding to countries needs to integrate climate change concerns into their core development strategies, improved domestic policies, and to access new sources of climate finance. We believe that our proposals go in this direction and this is why they should be considered into next G-20 discussions.