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Towards an equity crunch for the investments in infrastructures?

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The world will soon encounter a potentially enormous wave of capital investment. In emerging countries, 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. In mature countries, there is a pressing need to finance research and innovation, environmental programs, infrastructure, alternative energy, biotechnologies: to increase their share of long-term investment is crucial 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). Investment in strategic sectors could foster economic growth and enhance competitiveness and productivity. 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).

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 Long-term investment (LTI) in infrastructures is very serious.

That's the reason why 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 and prevent global crisis, but to create 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 positive externalities for growth than on financial short-term investment.

So, since the beginning of the crisis the LTIs Club, in many occasions, has posed these questions to policy makers and international organizations: in three Conferences held in Paris, Rome and Venice; in the Eurofi Financial Forums of Goteborg, Brussels and Paris; with an active participation in the preparatory work of the de Larosiére’s and Mario Monti Reports; and with a working paper presented to the EU Commissioner Michel Barnier in September 2010.

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, 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 European financial instruments such as long-term equity funds, Eurobonds and project bonds, 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.