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Symposium 1
Government as an Entrepreneur

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Symposium 1 Government as an Entrepreneur

Governments have involved themselves in anti-crisis measures to help companies and sectors recover from the downturn. At the same time, governments have invested in strategic sectors, which appear to provide promising growth opportunities in the future. What will the post-crisis global economy learn from this state investment and involvement? To what extent and to which sectors should this government support be offered; furthermore, when should it end? Does Europe need a structured government agency to play this role?

Entrepreneurship vs Regulation

Entrepreneurship vs Regulation

- **State Entrepreneur will most probably not come back unless new dramatic crisis (remember 1929) (with perhaps some exceptions for European strategic industries: *European dimension and strategic objectives could exclude State Aid discipline*)**
- **In free market economies Government intervention has to be “market conform”**
- In some key strategic sectors such as energy, high tech and utilities France and Italy still maintain majority State control of some large corporations. But overall the model of modern corporation is in the hands of capital markets
- Even in the cases of major banking bailouts – especially in the US and UK – State ownership will most probably be temporary and without exercising strong controlling rights

Entrepreneurship vs Regulation

The new role of Governments (and eventually of the EU) will have to concentrate on

- regulation (*and deregulation: reducing regulatory burdens*)
- special incentives (including tax incentives) to support the market and especially to promote R&D, strategic investments, and driving sectors
- enabling actions, industrial policies, public procurements, incentives to users' demand, others demand side stimulus
- investments in human capital, public and public/private research, infrastructures

Entrepreneurship vs Regulation

- European Industrial Policy was not considered neither in the Rome Treaty (1945) nor much in later phases
- European intervention was used to support specific industrial sectors hit by international crisis (as in the case of European steel industry at the beginning of the 1950s)
- Direct intervention, however, has been put in place by the EU in support to science and technology, as was in the case of Euratom (1957) and Esprit (1983)
- Intra-European industrial cooperation (without a direct intervention by the EU) has been a success in the case of Airbus, Eureka and, more recently with the direct intervention of the EU, of Galileo

- In the Political Economy of the EU the industrial policies have been left to member States

- We may say that the relationship between sovereignty and industrial policies in the EU have worked at the reverse – Europe does not act as a nation State but as an arbiter – on grounds of competition and State aid discipline - of national industrial policies and the behaviour of single industries

- ***The Crisis now may ask for a new role of the EU institutions in fostering growth and supporting the creation of European industries and long term investments***

Entrepreneurship vs Regulation

In fact, with the crisis the EU has made a first step towards a common and coordinated intervention. I believe this is good news, but we need to do much more

If Europe wants to compete with the US and with other strong economies in the world should learn from the American pragmatism and increase its direct intervention and procyclical long run demand side economics

By the way the US has always acted through strong demand side economic intervention

**Just think of the \$ 300 bn SDI initiative at the beginning of the 1980s
It paved the way to the e-economy and to many major high tech innovations**

Entrepreneurship vs Regulation

Creating a strong European industrial base is fundamental to securing the foundation of the EU's economy, and ensuring a sustainable progression towards a flourishing economy and an environmentally-friendly production

To this end, a coordinated approach on industrial policy is indispensable

And because of the rules on the single market and the need to avoid national protectionism, there is a need for an EU-wide approach

Entrepreneurship vs Regulation

The European Economic Recovery Plan (EERP)

European Economic Recovery Plan (EERP) includes targeted a stimulus of 200 billion euros, within both national budgets (around €170 billion) and EU and European Investment Bank budgets (around €30 billion). It sets out a framework for how funds should be used to stimulate investment, "green" Europe's economies and boost energy efficiency:

A key part of the Plan is a "smart mix" of regulation, R&D, national investment, EU funding, European Investment Bank support and public private partnerships for forward looking investments in key sectors like cars and construction

The Recovery Plan also includes proposals to stimulate labor markets and increase demand for energy efficient goods and services through innovative use of taxation

It includes also measures to help SMEs

Entrepreneurship vs Regulation

The plan includes a broad range of actions at national level and at EU level to help households and industrial firms (particularly automobile and construction).

The measures include:

- reflation: the Commission will allow Member States to break the [Stability and Growth Pact](#) for two or three years.
- incentives to investment: the plan outlines measures to encourage the fight against climate change and promotes strategic investments in buildings and energy efficient technologies.
- lower rates: the [ECB](#) is invited to drop its rates.
- tax rebates: lowering taxation on green technology and eco-friendly cars,
- social measures: the Commission proposed the governments to temporarily increase unemployment benefits and their duration, to increase allowances to households, to lower taxes on low incomes, to lower social security contributions paid on low wages by employers, to reduce labor costs paid by employees with low incomes, to provide subsidized loans or credit guarantees for companies, to reduce temporarily the [VAT](#) rate to support consumption. The Commission announced it would adopt by mid-March 2009 a proposal to lower VAT rates for services with high labor-intensiveness (such as catering).[

Entrepreneurship vs Regulation

The EU Plan includes the implementation plans for the three partnerships:

"Factories of the Future" initiative for the manufacturing sector (€1.2 billion for R&D)

"Energy-efficient Buildings" initiative for the construction sector (€1 billion for R&D)

"Green Cars" initiative for the automotive sector worth a total of €5 billion, of which €1 billion is for research activities

Entrepreneur ship vs Regulation

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National plans are often close to 1.2 percentage points of GDP, as recommended by the [European Commission](#), and are focused on 2008 and 2009. However, Germany and Spain have announced fiscal stimulus of respectively 3.3% (two plans altogether) and 3.7% of their GDP.

Entrepreneurship vs Regulation

The plan announced by the European Commission at the end of November recommended measures to revive the economy but did not specify much the nature of the plans. Some plans are focused on the stimulation of demand (United Kingdom, to a lesser extent Spain, Italy or the second German plan), other plans insist more in incentives to supply (French plan, first German plan).

Measures taken on expenditure to improve demand generally include measures to support medium-term growth through increased public spending on infrastructures (road networks and railway) and aids to the housing sector (notably construction and renovation). Several countries have also announced short-term measures to relieve the effects of the crisis on the poorest people (increase in benefits and allowances to households with low incomes and unemployed). However, these aids have often limited effects on the economy, because their amounts are insignificant.

Other measures affected national [taxation systems](#). The UK was the only country that opted for a temporary decline in the standard [VAT rate](#), by 2.5 percentage points. In Germany, employer contributions were lowered. Most plans include incentive measures to SMEs and development of [green energy](#)

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Entrepreneurship vs Regulation

The fiscal dimension of the US Recovery Plan

Consider that the measures provided by the US Recovery Plan are worth \$787 billion (of which 37% tax cuts and 45% federal spending programs).

Among the spending programs:

- \$ 220 billion to support to industrial and service sector investments, of which:
 - \$80.9 in Infrastructure Investment
 - \$29.5 in Investment into government facilities
 - \$7.2 for complete broadband and wireless Internet
 - \$61.3 for Energy
 - \$12.7 Energy Housing
 - 8.9 Scientific Research
 - \$15 Supplemental investments

Investment (how, what,...)

Growth and Longer Term Development

- Public debt/GDP ratios of "advanced economies" within the G-20 peaked to 102% in 2009 and are expected to reach 122% in 2014.
- Restoring sustainable debt over the medium term will be indeed a formidable task.
- The adjustment required should be based on structural reforms of public expenditures and tax systems. (like reform of the welfare state, fighting tax evasion, fiscal federalism and, generally, more compulsive rules on local expenditure's responsibilities)
- Such a large medium long term fiscal consolidation will most probably slow down growth rates.
- ***Harvard economists Christoph Reinhart and Kenneth Rogoff have recently shown that, historically, countries with public debt/GDP ratios over 90% grew 1% less than countries with ratios under 90%.***

The Potential Contribution of Long Term Investments to Growth

- **Low growth, reducing tax revenues and increasing debt to GDP ratios, will make harder the adjustments required.**
- Therefore, together with structural reforms, sustaining long-run growth should be the first priority of policy makers. For doing so, increased investments in infrastructure and “common goods” are needed.
- Major investments in the fields of innovation, renewable energies, water networks, telecommunications and transport infrastructures are in any case required for shifting to a low-carbon economy, coping with the scarcity of natural resources, adapting to rapid urbanization and increasing competitiveness.
- These are all sectors which themselves can yield high investment returns, stimulate follow-on investment and, as a result, create growth and jobs.

Golden Rule and investments in “common goods”

- The demand in Europe for Infrastructure, Energy, Climate Change, Strategic and Urban Infrastructure in Europe is huge. It is estimated in over 3,000 bn euro in the next ten years!
- Some new form of Golden Rule (extended also to the financing of European long term investments) may perhaps be reconsidered in the new Growth and Stability Pact (GSP)
- Anyway, it is clear that the European countries will not be able to finance such investments mainly with their own budget resources as do low public debt countries (such as China, Korea, Russia, Australia, etc.)

The Public/Private “Complementary” Approach

.We need , then to attract larger amounts of private capitals, ready to invest long term

- But we know, from economic theory, that high public debt produce the so called “crowding out effect” of private investments

- This - I suggest - maybe avoided if the public and private sector work together building strong “complementarities” - i.e. if new forms in the relationship between the public and the private sectors should be explored

- But also **by:**

- **Fiscal Incentives**

- **New regulatory and accounting rules for long term investments**

- **Incentives for PPPs and PFIs**

- **New financial instruments (Long Term Equity Funds, Project Bonds, Guarantee Schemes)**

- **By creating European Common Undertakings in strategic sectors (such as Energy, Transport and TLC)**

Long Term Investments for a strong, balanced and sustainable growth

- Policy-makers will not achieve their dual aim of restoring economic growth and preventing a repeat of the recent market meltdown unless they set in place the **right conditions to foster long-term investment**.
- The market collapse was primarily caused by two factors: An obsession with short-term priorities by investors, and a profound disconnect between financial instruments and the needs of the real economy.
- The implementation of long-term global objectives, such as infrastructure building and fighting climate change is not only an absolute necessity. It is also a means, in itself, to recovery.

The Strengths of Euroland

- Historically Europe has high households' savings' rates.
- Financial capital surplus countries (especially in low public debts emerging economies such as China, Singapore, Russia, Arab Gulf Countries, India, Brazil, Mexico) may find Euro denominated investments attractive (also as a way to diversify their dollar denominated investment products).
- Therefore Euro denominated long term instruments to finance EU strategic investments may find in European households' savings and global markets the resources needed (outside the national public budgets).

Sectors - which infrastructure - -Future investments

The strategic role of Long Term Investments

Europe can stimulate growth in coming years by investing heavily in sectors that ensure “strong, sustainable and balanced” economic growth such as innovation, human capital, renewable energies, TLC, biotechnologies, environment, transport, energy and telecommunications infrastructures,

- generating major positive externalities for the economy, the environment, and social cohesion
- making use of innovative, long-term financial instruments that do not burden public finances and consequently, future generations
- and therefore helping to readjust public finances through renewed growth in GDP and, consequently, revenues.

The EU Demand for Long Term Investments

Strategic investments in infrastructure, energy, telecommunications and human resources play a key role in improving quality of life and social cohesion, necessary positive prospects for the economy as a whole

Transition to a low carbon economy and laying groundwork for rapid urbanization, are examples requiring major investments in technological innovation, renewable energy, water infrastructure, telecommunications and transport. Such industries are capable of generating attractive returns, stimulating “virtuous chains” of investment and fuelling economic growth and job creation

The Demand for Infrastructure in the EU-27

World demand for investment in energy, the environment and infrastructure is set to boom over the next few years.

In Europe, the demand for infrastructure will be huge. The overall cost of the Trans-European Transport Network (TEN-T) still to be financed has been assessed at around €500 billion by 2020.

The overall cost investments in Energy and Climate Change is estimated in over 2,500 billion by 2020. It includes energy infrastructure (electricity transmission, gas pipelines, and in liquefied natural gas terminals), energy generation, renewable energies (solar, wind power, biomass) and environment systems and infrastructures.

The Future Supply and Demand for Long Term Investments

How can Europe attract financial resources from European private investors and extra European private/public investors for financing strategic European projects in the fields of innovation, infrastructures, human capital, renewable energies, TLC, biotechnologies, notwithstanding their long term and moderate (not speculative) IRR?

EU should build up on a wide range of attractive instruments:

- fiscal incentives and special regulatory and accounting rules for long term investments with strong “positive externalities”;**
- a class of new financial instruments to finance long term projects/initiatives with moderate (non speculative) yield but with a low risk profile thank their issuers’ high institutional standing/reputation;**
- by promoting the action of a selected class of special long term investors with special public endorsement and/or guarantees, collecting private financial resources.**

Duration - Strategic vs Opportunities

Financial System Regulation

- The current crisis was largely caused by the short-termist behaviour of financial markets and by the disconnect between investment strategies and the needs of the real economy.
- The so-called “shareholders’ capitalism” created strong incentives to maximize short-term, rather than long-term, value. Indeed, managers of the firms were “winners” if they maximized the value of the shares, which was directly related to generous bonuses and stock options.
- The excess of liquidity coupled with deregulation of financial markets and institutions, exacerbated arbitrage and short-term speculation.

Incentives for Long Term Investments

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

corporate governance

As proposed by the de Larosière Group Report on Financial Regulation and Supervision.

New Instruments for Financing Long Term European Strategic Investments

- EU Equity Funds
- EU Project Bonds
- EU Debt
- EU Guarantee Schemes and, generally, “credit enhancement” initiatives

The “Marguerite Fund”

A first example of an EU long term financial instruments is the **“2020 European Fund for Energy, Climate Change and Infrastructure (Marguerite)”** set up recently by

European Commission

European Investment Bank (EIB)

Caisse des Dépôts et Consignations (CDC - France)

Cassa Depositi e Prestiti (CdP - Italy)

KfW Bankengruppe (KfW - Germany)

Instituto de Crédito Oficial (ICO - Spain)

Powszechna Kasa Oszczędności Bank Polski (PKO - Poland)

- It is a pan-European equity fund for investment in energy, climate change and infrastructure, with a target of 1,5 bn euros and a 5 bn debt facility.

- It was endorsed in December 2008 by ECOFIN and the European Council as a key measure of the European Economic Recovery Plan (EERP).

The “Marguerite Network”: a reinforced cooperation?

- The Marguerite Fund is in fact a good example of “reinforced cooperation” in the European financial sector (the first was the Euro). It could become the prototype of a “family of European Funds for Growth” to support the market in financing the objectives of the Lisbon Agenda.
- In fact, this is not a cooperation among the EU member States, but among some long term investors totally or partially owned by the States : The “Marguerite Network”.

The “Marguerite Network” and its Instruments

- The Marguerite Network will launch other initiatives for financing with private capital European long term investments such as:
 - Some other Equity Funds (like InfraMed,),
 - Project Bonds
 - Guarantee schemes
- The “reputation premium”, which may come from the EU endorsement and by the “high standing” of the long term institutions involved, as project sponsors, may:
 - decrease the cost of financing,
 - increase the credit ratings of the bonds,
 - creating an asset class which may attract large institutional investors (by matching their own liabilities – long term, fixed income) and medium size European (retail) households’ savings.

Long Term Investors: a New Class of Financial Institutions

- More generally speaking, long term investors may play a key role in sustaining directly and attraction capitals for strategic investments.
- 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), but also large pension funds, insurance companies, non-profit institutions, development banks and SWFs if:
 - 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 a clear social responsibility in their missions.

This allows them to “accept” non speculative returns on their investments, as well as the willingness and the capacity to keep in their books long term assets and liabilities.

Fiscal opportunities

Fiscal Incentives for Long Term Investments

From a fiscal policy point of view, we may even think of introducing special *ad hoc* 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.

The fiscal incentives may go directly in favour of the investors. This may trigger arbitrage effects. However, this is exactly what the incentive is trying to achieve, that is to make it more convenient for investors to hold long term rather than short term and speculative investments. This is the same logic behind the fiscal disincentive that a buyer of a real estate asset has in selling back it before a reasonable period of time which does not allow for a speculative operation (usually 3-5 years).

Fiscal Incentives for Long Term Investments

The fiscal incentive may also be in favour of financial institutions which decide to hold part or all of their assets as long time investments. The fiscal incentive in this case would go to the type of investor.

The fiscal incentive may also go, not to the type of investor, but to the type investments. Some investments may be eligible to be long term investments if they have certain specific characteristics. The characteristics may regard the financial structure of the investments, which then relates to a long term type of project. Then types of projects and sectors may also become specific characteristics which make them eligible for special type of fiscal incentives.

In short, there are different possibilities which should be explored to create a system of fiscal incentives as part of a policy that Governments may decide to pursue to support and stimulate long term investments, because these type of investments or of investors in their activity give a contribution for the production of “positive externalities” for the economy and for society as a whole.