New Regulatory Framework and Instruments for European Long Term Investments after the Crisis

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Abstract

An European road map for a stable and durable growth goes through a major program of long-term investment. This is essential both for securing the region's elite status in the fields of knowledge, technology, environment, culture, social cohesion and civil progress, and for fostering growth and competitiveness. However, the binding budget constrains prevent most EU countries, heavily weighted down by the crisis, from financing these investments with public resources. Therefore, to finance such an ambitious program the EU needs to increase its capability to attract long-term private and public-private capital from global markets. In this framework, the importance of the European institutional long-term investors and development banks (such as the EIB, the German KFW, the French CDC and the Italian CDP) is going to rise in the coming years.

The EU should set up a special agenda including a revised regulatory, accounting and fiscal framework, as well as the creation of new long-term instruments for financing infrastructure (such as EU equity funds, project bonds common initiatives on debt supported by special guarantee schemes). On the accounting side the introduction of new special criteria (in framework of *Basel III* and *Solvency II*) distinguishing between different temporal durations matching liabilities and investment, should be considered, as proposed by the EU Commission following the de Larosière Report and by the Eurofi 2010 Forum's Final Report. Appropriate accounting rules for long term investors will give a substantial contribution to promote long term policies. In that respect, we welcome the objectives set in the EU 2020 Strategy and the Monti report on the Internal Market strategy, but we would like to draw attention on the fact that banking prudential regulations and financial reporting standards, as currently discussed, do not fit with these objectives.

More generally, by implementing strong and proactive cooperation policies with the emerging economies, Europe will attract foreign capital and offer technology, at the same time. In this way, the exchange will permit bilateral gain and uphold common goods. To be more competitive in the scenario of optimal reallocation of capital, due to the effects of future global imbalances, the EU must increase the euro's leverage using a better combination of long-term

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capital and debt instruments. These actions, eventually together with the issuance of European Sovereign Debt securities, will strengthen the alliance of European peoples, increase global competitiveness of European economy and secure the political cohesion of the Union.

A new European architecture is taking form, which is a very positive consequence of the crisis. It is a common system of economic governance that is based on a new role for the EIB, the new Anti-crisis Fund, the new Growth and Stability Pact. It constitutes a common European policy of fiscal responsibility. These three pillars should protect the European markets and currency from potential external tensions and should create a strong and stable fiscal environment. This in turn will have a positive effect on the attractiveness of euro-denominated financial instruments. We believe that LTI philosophy and proposals should be included in the very foundations of this new European system of governance.

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1. *The European Union's and Member States' budget constraints and the need to attract capital from global markets*

It is easy to assume that the economic and financial crisis of 2008-2009 have been radically alter the European Union and the national Member States programs managing resources and budget.

An appropriate exit strategy to lift the Union out of crisis is still debated. Since the immanent negative effects of recession has been tackling mainly through discretional fiscal intervention followed by accommodative monetary policies, a credible exit strategies that stimulate and foster long-term growth should include forward looking measures. Some choices remain exclusively the province of national governments, though it is hoped that adequate cooperation within Europe and support by the world community will soon arise. Surely shared policies by an integrated Europe focusing on a common good, would yield better results.

According to a recent report by the International Monetary Fund[1], the financial crisis have had a significant impact on the public finance of most countries throughout the world with negative effects which will stretch over the coming years. The debt/GDP ratios of the "advanced economies" came to 90.1% of GDP in 2009 and could reach 108.1% in 2015. Meanwhile, the debt of the emerging countries seems to remain broadly stable at around 34% of GDP at the end of the 2015.[2] Within advanced countries, the weight of public debts could heavily increase: in the United States from 84.3% in 2009 to 110.7% in 2015, in the Euro Area from 79% to 89.3% and in Japan from 217.6% to 249.2, respectively. France (from 78% to 96.3%) and the United Kingdom (from 68.7% to 98.3%). Taking a long-term view without strong fiscal consolidation policies ,the debt/GDP ratios of countries with mature economies in 2050 could even exceed 250%.

The expected increases are mainly caused by the strong reduction of tax payment due to the output fall.[3] Moreover, about one quarter of the new debt could depend on the decline of financial sector activities and in particular and to the falling revenues resulting from lower asset prices.

[1] See IMF (2010), World Economic Outlook, Rebalancing Growth, April.
[2] See figure 1.
[3] See figure 2.

Fiscal stimulus policies and the intervention in support of financial system represent only a small part of the new debt (10% and 8% of the expected increases of total debt, respectively). In this framework, discretional fiscal policies have been playing a big role in stimulating real activities and stabilizing output, even if their contribution to the deterioration of debt to GDP ratios seems to be marginal.

According to this scenario the IMF's recommendations tend to underline the need to fiscal consolidation strategies especially in those countries in which the large increases in risk-premiums could generate strong financial instability and uncertainty on the future recovery of the economy. However, in a medium term perspective stronger policies designed to foster potential output must be implemented. These interventions needs to take into account the fact the long term fiscal consolidation could depress the aggregate demand also in the current times due to the inter-temporal effects of these plans on the agents choices. Thus, the credibility of growth recovery dynamics in those countries which has been experiencing a strong deterioration of public balance goes through structural reforms that favour private saving (and investment) rather than consumption and limiting at the same time the counter negative impact on private demand of fiscal consolidation in the short term.

The recommendations advanced by the IMF, are entirely reasonable, but seem both difficult to implement and perhaps insufficient to tackle the system-wide scale of the crisis. Now seemingly traditional steps seeking to ensure that fiscal stimulus measures are temporary, avoid protectionist policies, curb deficits sharply after the crisis has passed, undertake structural reforms to encourage growth and reform pension and healthcare systems, are sensible, but the "conventional wisdom" of the International Monetary Fund has to contend with new demands and problems.

According with the main international projections[4], in 2010 the growth of world output seems to be stronger than expected and estimated at about 4,5%. Moreover, also in 2011, the world activities will experience a phase of expansion[5]. However, the recovery processes continues to be particularly heterogeneous among countries. Since the gap in terms of growth between advanced and emerging countries can not be considered

[4] See IMF (2010), World Economic Outlook Update, July.
[5] See table 1.

surprising, the differences within the former must be analyzed properly. In particular, according to IMF (2010) predictions, the United States will growth at a rate equal to 3.3% against the 1,1% of the Euro Area with a gap which will remain positive also in 2011 (2.9% *vs* 1.3%, respectively). In the Euro Area the patterns are different, too. The growth of Germany and France is estimated at about 1.4%, in Italy at only 0.9%, while in Spain recession phase seems to be not ended yet. Europe, therefore, more than others needs to implement a general recovery plan in which the different instances and difficulties of member states must be taken into account. Since both financial market and regulatory inefficiencies have deeply contributed to the diffusion of global crisis, fiscal adjustment, must be accompanied by new development in financial sector as well as reform in the regulatory and supervisory schemes.

In Europe, the debt/GDP ratio may be reduced[6]: by generating inflation, surplus production and increasing the GDP. The first route is not advisable, and would surely be counteracted by ECB. However, at the global level (especially in the United States, which has a much more “flexible” monetary policy), we cannot rule out the "administration" of a dose of inflation to help deflate the debt balloon generated during the crisis. Recently, it was estimated that with 6% inflation over the next five years the average ratio of government debt to GDP of the advanced economies could fall by 8-9 points, compared with the baseline scenario (inflation at 2%).[7] Obviously, double-digit inflation would have a significantly different impact. Troubles experienced during the 1970s counsel against taking this path. In fact, high inflation seriously distorts the allocation of resources, reduces the rate of economic growth, hits the poorest citizens the hardest, creates social and political instability, and once unleashed, inflation is hard to contain and negative effects are unpredictable. Price stability must be maintained and central banks should work to ensure it.

[6] In addition, obviously, to privatisation, the assignment of receivables, and, indirectly, the disposal of public assets, as well as other “extraordinary” operations involving the so-called “residual component” (stock-flow adjustments).

[7] The estimate was presented by Ken Rogoff, Professor of Public Policy at Harvard and former chief economist of the IMF, in various recent remarks. For example" Countries are so deep in debt, they risk drowning in red ink", The Globe, 10 November 2009. According to another recent estimate, a 6% inflation maybe produce a 20% reduction of the public-debt-to GDP ratios. See Aizenman and Marion, “Using Inflation to Erode the US Public Debt”, NBER Working Paper 15562, 2009.

The second route to cutting public debt, generating significant surpluses over several years, would be difficult to achieve on a practical level, though seemingly a lone alternative. In the last 15 years, no major Western country has managed to curtail current spending,[8] and most of the surpluses (or the initiatives that directly contributed to reducing the debt) were achieved by extraordinary measures, such as privatisations, tax amnesties and accounting operations. At most, a rigorous fiscal policy would keep the ratio constant, but reducing it is very difficult. The IMF estimates that in order to cut government debt to pre-crisis levels, the average budget adjustment of the G-20 advanced economies (between 2011-2020) would have to be on the order of 8% of GDP, of which, 1.5 points in lower costs for economic stimulus measures, 3.5 points in cuts to primary expenditure (excluding healthcare and pensions), and 3 points in revenue measures, such as tax rationalisation, curbing tax evasion and tax increases. A further 3-4% of GDP will be required to tackle healthcare costs and pension obligations as a result of demographic developments. This achievement would require a decade of spending cuts or tax increases nearing 1-1.5% of GDP annually. In other words, each year, for 10 years, the EU-27, the largest economic area in the world, would be required €150-€200 billion in spending cuts (or revenues increases). Quite a politically treacherous path to take – and dangerous if popular support denied a political class showing no more resources - offering only spending cuts or higher taxes. It is likely that the issue of the "new fiscal crisis of states" will once again dominate political discussion in the coming years.

Finally, the third option would be to boost the average rate of GDP growth. While a most desirable solution, is not easy to achieve. Countries with mature economies post modest, if not stagnant, growth (in the last 15 years, growth has not exceeded 2%, while 30 years prior, growth averaged 5%). The much vaunted reforms to liberalize markets, boosting competition and expanding free-market forces, have not yielded desired results. Nevertheless, growth is a strong ally in the fight against debt. For example, with debt equal to 100% of GDP, an annual 1% year increase in growth (assuming constant public spending and a tax burden of 40%) could reduce the debt/GDP ratio by 28 percentage points over 10 years.

[8] However, it should be noted that Italy reduced its expenditure in respect of compensation of government employees by 2% of GDP between 1994 and 2000 and the country still has ample room for a rigorous policy of cutting current spending, particularly in intermediate consumption by government departments.

As discussed above, the crisis is had a severe impact on public finance in all major EU member states and nearly all other mature economies. Thus, rising debt taps the EU's current resources it becomes increasingly arduous to obtain grants from the EU budget to finance common European policies - especially investments in major infrastructure projects and industrial policy programmes: a key part of any crisis exit strategy.

However, globalization has also allowed Europe interesting opportunities. Emerging economies, with considerable monetary and financial surpluses, are prompted to diversify the management of their reserves and investments, and thus ready to allocate a larger portion to Europe.

In the near future, securities issued by EU member states will no longer be drawn from a disadvantaged position among sovereign issues of the world's major countries. Rather, Europe appears to be in a good place to increase its leverage and attract capital from global markets, thereby financing long-term investment in infrastructure projects (transportation, energy, telecommunications) that generate guaranteed, albeit deferred, returns.

In other words, once the crisis has definitely passed, European infrastructure projects must seek financing from private capital and non-EU public capital rather than rely on the unlikely prospect of receiving funding from national government budgets. Innovative financial instruments will be needed to achieve success: the topic to be explored in greater depth in this paper.

2. *Global Imbalances and Long-Term Investments: A New Perspective after Financial Crisis*

Looking forward, the contrast between the old and new worlds will be starker. The old world, rich and powerful, is aging and falling further into debt. The new world, still weak and poor, is young, far less indebted, and is expanding rapidly and therefore has greater potential to accumulate savings. Where will those flows of savings go over the next 20 or 30 years? What reserve currency will the central banks of the world's countries choose? What government securities will the new Chinese, Indian, Brazilian and Russian middle classes select for their portfolios? At the moment, about 80% of financial savings are held by Western countries. However, the financial assets of the emerging countries are expanding at a very rapid rate (2 or 3 times GDP growth). Over the long term, enormous structural changes are to be expected, some sketches seem already emerging. Predictions are easily traced from available data, if viewed from the typically neo-Keynesian macroeconomic stance of the IMF economists, authors of forecasts. New assets acquired by governments during the crisis could increase in value considerably once the financial storm has subsided. However, these trends could be upended by unforeseeable government actions and policies.

The scenario just outlined poses questions not easily firmly answered. Should a "massive" rebalancing of the monetary flows from the old world to the new be expected? Could the mighty giants of world capitalism decide to engineer a massive dose of inflation to reduce the burden of debt, bringing on serious risk of triggering "new ideological insanities" – thereby wreaking grave social harm and havoc? Will the ECB and the Federal Reserve simply sit back and let this ill-omened scenario happen? Can conflicting interests be reconciled through a system of "world economic governance," capable of implementing major, long-term policies for environmental, social, demographic, commercial and monetary sustainability?

In many emerging economies savings surpluses are expected to be persistent also in the coming years[9], while the absence of robust policy to support domestic saving as well to stimulate potential output growth intervention in the advanced economies will contribute to maintain the presence of "global savings glut" at world level. Since the presence of global imbalances is not necessarily negative (or undesirable), in the coming years it is going to be important to understand, especially for Europe in which binding budget constraints will not allow for strong discretionary long-term investment strategies, if a rebalancing of global savings could lead to an different resources allocation which guarantees a robust growth in Euro Area and potential gains in terms of revenues, technological transfers and innovation diffusion.

The evolution of global imbalances: what we know

In the last decades, the saving and investment behaviours in world economy is deeply changed. The current account (CA) imbalances are reflecting these gap between surplus

[9] See table 2.

countries (emerging and developing economies) and net debtor ones (mainly the advanced countries), even if during the financial crisis global external imbalances (measured as the sum in absolute terms of the current account positions of all countries) had started to reverse after a long period of strong growth.[10]

As noted by Caballero et. al[11] three key facts have characterized the dynamics of the global economy in the recent years. Firstly, starting form 1990 US has shown a persistent a growing current account deficit, with Japan, Continental Europe and both emerging Asian and European countries as counterpart of these huge external deficit. Secondly, due to accommodative monetary policy, the long real interest has been decreasing over time. Finally, the weight of US assets in the international portfolio has increased steadily during the same period also because the distortions caused by financial crisis, asset prices bubbles and excess liquidity.

By definition the current account of one country is the difference between national savings and investment; thus the determinants of the evolution of current account positions must reflect the dynamics of the saving-investment balance both at country and world level. Several studies have been conducted with the aim to identify the determinants of current account disequilibria[12]. Accordingly, different factors can be considered. Fiscal balance can play an important role in explaining current account dynamics because an increase in public deficit can reduce domestic savings in absence of perfect Ricardian effects. Moreover, as argued by Cheung et al. (2010), the impact of public deficit on CA balance may depend also on the composition of public expenditures. In fact, precautionary savings in both advanced and developing countries can decrease with higher social spending through a so-called insurance effect. On the other hand, lower level of social expenditures (health, pensions, social security, etc.) can lead to an increasing volume of household saving. Demographic dynamics can also explain a big part

[10] See, figure 3.

[11] Caballero, R., Farhi E. and Gourinchas P.(2008). "An Equilibrium Model of 'Global Imbalances' and Low Interest Rates." American Economic Review 98 (March): 358-93.

[12] Cheung, C., D. Furceri and E. Rusticelli (2010), "Structural and Cyclical Factors Behind Current Account Balances", Economics Department Working Paper, No. 775, OECD, Paris; Chinn, M.D. and H. Ito (2008), "Global Current Account Imbalances: American Fiscal Policy versus East Asian Savings", Review of International Economics, Vol. 16, pp. 479-98; Chinn, M.D. and E.S. Prasad (2003), "Medium-term Determinants of Current Accounts in Industrial and Developing Countries: an Empirical Exploration", Journal of International Economics, Vol. 59, pp. 47-76.

of the current account disequilibria due to different saving behaviours between countries. In fact, according to life-cycle theory, counties with higher portion of elder people experiment larger current account deficits.

Other important driving forces of global imbalances are the level of financial development and the quality of political institutions. Especially for the less-advanced countries it is possible that the private saving is shifted form domestic to more developed financial markets to ensure a safety channel for investment. Moreover, it is possible to argue that, the quality of institutions, as well of financial market structure can lead to a lower level of precautionary savings in advanced countries because of the presence of weaker borrowing constraints. Furthermore, global imbalances are also related with the growth rate of each country, since international capital can be attracted by expectations of high returns in economy showing high level of productivity growth, and with the level of trade integration. Finally, current account balance can be affected by the relative importance of oil production in the domestic economy. Oil exporters can show high surpluses in period of increasing oil prices, especially if these variations can be considered permanent.

In summary, the determinants of current global imbalances can be classified following both a domestic of international perspective. The so called "global saving glut" view[13] considers as origin of global current account imbalances the excess of savings form Asian emerging markets countries produced after the financial crisis in 1997. According with these explanation, the current account deficit of US is mainly caused by external factors, and the sustainability at global level can be achieved only in the long run when the development of the world financial system favours an better allocation of excess savings in surplus countries. As noted by Obstfeld and Rogoff[14], this view is consistent with accommodative monetary policy and low real interest rates. On the other hand, many studies have shown the importance of domestic factor, in particular fiscal policy and public debt, in explaining those imbalances. This is the "twin deficit" argument in the case

[13] Bernanke, B. S. (2005). "Remarks by Governor Ben S. Bernanke: The Global Saving Glut and the U.S. Current Account Deficit." The Sandridge Lecture, Virginia Association of Economists, Richmond, VA (March 10).

[14] Obstfeld, M. and K. Rogoff (2009), "Global Imbalances and the Financial Crisis: Products of Common Causes", Paper prepared for the Federal Reserve Bank of San Francisco Asia Economic Policy Conference, Santa Barbara, CA, October 18-20, 2009.

of US, for which current account imbalances are caused by a reduction of domestic savings mainly driven by the US federal budget deficit. Chinn and Ito (2008) have provided a brief theoretical explanation with the aim to show that the two interpretations can coexist in explaining the actual imbalances. In particular they argue that it might be possible to have a situation in which we find an expansionary fiscal policy in US that lowers the level of savings in domestic economy and at the same time, a reduction in the investment levels in some other foreign countries as a result of an exogenous shock (the case of the financial crisis in the South-East Asia). In a static representation of the world economy, these coincident events drive down the real-world interest rate and US current account deficits rise in relation to the East Asian current account surpluses.

We move now to analyze the dynamics of global imbalances in the last years taking into account the theoretical and empirical predictions of the economic literature discussed above.

In the mid-1990s the dimension of global current account were on the whole unexceptional, in particular, even if the current account deficit of US was quite large in absolute terms, its weight, expressed as percentage of GDP, was about 1.5%. Nevertheless, after the Asian Crisis (1997), CA surpluses were favoured by weak currencies in developing Asian countries and Newly Industrialized Countries and by strong economic growth in China. Moreover, the increase in commodity prices after the crisis recessionary period generated surplus in oil-exporter countries. In the same time, widening deficits arose form many advanced economies. The surpluses of Asian countries remains persistent after the crisis period because private saving rate reached the pre-crisis level while the investments declined sharply. CA surpluses in these countries were supported also by exchange rate policies: rates at competitive levels with respect to pre-crisis period, in order to benefit form export-led strategies and to accumulate international reserves as buffers against future financial crisis. After 2000, the strong growth in China favours the addition of an excess of savings in the global capital markets. Starting from 2005, surpluses of China and oil exporting country have become one of the major counterpart of the global deficits.

Meanwhile, in the first years of 2000s, equity prices played an equilibrating role in international financial markets. In particular, the expectations of future productivity growth in US attracted capital from emerging market savers, which flowed in US causing an increase in stock prices and a appreciation of US-$. After 2004, under a generally accommodative monetary policy in advanced countries (especially in US), low interest rates, and a strong emerging countries growth (China), the overall deficit rose for advanced countries. In addition, the global demand for excess savings was also stimulated by the growing deficits in Eastern Europe countries.

Therefore, as argued by Obstfeld and Rogoff (2009), the low interest rate in US has favoured an increasing in market expectations, distortion in asset market, as well as in markets for housing finance. In this framework, the interaction between financial innovations, low interest rate and strong expectations of housing appreciation produced an increase in consumer spending and borrowing. As we already know, the stock of mortgage debt grew rapidly, as well as structured financial products built on it.

After 2005, the Fed decided gradually to rise the funds rate. Later, in 2006, the real long-term rates began to rise in other industrial countries Meanwhile, housing prices appreciation began to stop in the early 2006, and the first evidence of one of the most deepest financial crisis of the last years began to rise.

Global imbalances and financial crisis

As many commentator have noted, global imbalances can not be considered the only and main cause of the recent financial crisis. It is true, however, that international imbalances and world crisis may represent the “two sides of the same coin” [15] or in other words “products of common causes”. We agree in fact with the thesis that the large global imbalances of last years have played a important role in increasing the risks associated with global economy.

The strong global disequilibrium in the saving behaviours among countries as well as unrealistic expectations of productivity growth in US, have contributed to strengthen the bubbles in asset and housing prices. However, the lack of coordination at international level and the following economic policy decisions carried out by most advanced countries have definitively concurred in worsening the financial and global stability. As discussed

[15] Bini Smaghi, L. (2008). “The Financial Crisis and Global Imbalances: Two Sides of the Same Coin.” Speech at the Asia Europe Economic Forum, Beijing (December 9). URL: http://www.bis.org/review/r081212d.pdf

above, the accommodative monetary policies of the most important international players did not favour the adjustments process needed to re-equilibrate these imbalances.

Finally, the well-known distortions present on international capital markets have generated the multiplicative effects which have reinforced the transmission mechanisms of financial and economic crisis.

As noted by IMF report (2010), with regards to global imbalances the recovery dynamics seem not to be very slow. The reduction in the Global imbalances during 2009-10 as a result of the financial crisis is due to both a strong decline in the United States' deficit and in the surplus of the oil-exporting countries. Nevertheless, only small efforts are devoted in reducing the structural driving forces of global disequilibrium. Shared actions to favour a real financial sector development in emerging markets must been considered if we want to prevent future instability due to the excess of savings in the growing economy. On the other hand, it is possible to think that a new allocation of international savings could be desirable if the reduction of US assets importance in international portfolio is associated with a increasing role played by Europe financial instruments.

A new long-term perspective for the "global saving glut"

As stressed by De Mello and Padoan[16], widening global imbalances are not necessarily undesirable. In fact, their presence reflects the development of global capital market and it is the signal of a growing trade e financial integration across countries. According with this views, it is possible also to argue that widening imbalances represent a general mechanism through which a more efficient capital allocation is achieved. However, the sustainability of global imbalances reflects the sustainability of external debt positions to the extent that current account deficits measures the debt indebtedness of a country. In different studies[17], quantitative analysis are performed in order to verify the stationary hypothesis on the current account time series. In fact, due to the well known mean-

[16] De Mello L. and Padoan P. (2010), "Are Global Imbalances Sustainable? Post-crisis Scenarions", paper presented at the Second International Conference on "Long-Term Investments in the Age of Globalisation", Accademia dei Lincei, Rome, June 17th.

[17] Wu J.L., Chen S.L. and Lee H.Y. (2001). "Are Current Account Deficits Sustainable? Evidence from Panel Cointegration", Economic Letters, 72, 219-224; Husted, S. (1992). "The emerging Us Current Account Deficit in the 1980s: a Cointegration Analysis", Review of Economics and Statistics, 74, 159-166

reverting properties, a stationary current account is consistent with the absence of incentives for a country to declare default on its external debts and then with the long-term sustainability of these positions. Moreover, the inter-temporal approach to current account also predicts a stationary behaviours of external imbalances as shown in the pioneer model of Obstfeld and Rogoff[18]. According to these studies, there is a quite consensus on the long-run sustainability of global imbalances even if several adjustment mechanisms are needed to ensure e new and different equilibrium. In particular, a medium-term real currency depreciation (appreciation) is needed to ensure the reduction of a current-account deficit (surplus). In fact, to equilibrate the current account balance, the gap between the (relative) domestic demand and the (relative) domestic supply must reduce[19].

Especially for Europe, a consistent exit strategy for a stable and durable growth goes through a credible investment policy in energy, environment, infrastructure, and research and innovative activities. As we stressed, the binding budget constrains of the most advanced countries, heavily weighted down by the counter cyclical interventions, seems to not allow the individual policies to pursue these main goals. International capital flows can match the long-term exit-strategy policy mainly based on strong investments in infrastructure (see for instance the Obama's infrastructure plan and the EU "2020" strategy). Thus, we expect that the global demand for infrastructure will grow rapidly in the next year. The overall cost investments in Energy and Climate Change is estimated in over 2,500 billion by 2020. It includes energy infrastructure, energy generation, renewable energies, and environment systems and infrastructures

Meanwhile, the current high debt and/or budget deficits of most advanced countries can lead to a reduction over the next years of the supply of government bonds of these countries. Thus, this process could favour a rebalancing of capital flows from surplus to deficit countries towards corporate bonds, equity and/or foreign direct investment. Of course, this shift in the international capital allocation can take place only if the return-

[18] Obstfeld, M. and K. Rogoff (1995), "The Intertemporal Approach to the Current Account", Handbook of International Economics, 3, 1731-1799.

[19] This implies both a decreasing path for the relative price of domestic nontraded goods and a deterioration, of terms of trade for the domestic country. See, Obstfeld, M. and Rogoff K., (2005). "Global Current Account Imbalances and Exchange Rate Adjustments," working paper, UC Berkeley (2005).

risk profile of new and different instruments of public or public-private securities will fit the preferences of long term investors and international savers.

Moreover, the ongoing globalization can also create interesting opportunities for Europe. Emerging economies, with considerable monetary and financial surpluses, are prompted to diversify the management of their reserves and investments, and thus ready to allocate a larger portion to Europe. As more advanced economies compete to attract resources from the rest of the world, it is probable, that the euro will strengthen in relation to the dollar in its stability, reliability and thereby fortify the securities issued by European institutions.

In this way Europe needs to implement strong and proactive cooperation policies with the emerging economies, in order to attract foreign capital and offer technology, at the same time. In this way, the exchange will permit bilateral gain and uphold common goods.

To be more competitive in the scenario of optimal reallocation of capital, due to the effects of future global imbalances, the EU must increase the euro's leverage using a better combination of long-term capital and debt instruments. These actions, together with the issuance of European Sovereign Debt securities, will strengthen the alliance of European peoples, increase global competitiveness of European economy and secure the political cohesion of the Union.

The Decline of the Dollar and the Rise of the Euro?

Under the prevailing interpretation, the 2007/2008 financial crisis has weakened the dollar and opened up new opportunities in the global monetary panorama.

The dollar has indeed strengthened. Investors, when shaken (by turmoil), largely sought refuge in US government securities market: the most liquid in the world and, in recent times of tremor, widely considered the place to safeguard savings. There has been no real loss of confidence in the dollar's stability.

As regards central bank reserves, IMF data show that 64% of the world's reserves are in dollars and that this figure has continually risen over the last two years[20]. Thus, while it

[20] The data on the estimated composition of central bank reserves are found in IMF, Currency Composition of Official Foreign Exchange Reserves (The COFER database), September 30, 2009.

is true that during the crisis American investors shifted their assets from deposits and bank securities to government securities, before gradually shifting back, this does not appear to be the case for the world's central banks; they have regularly accumulated dollar-denominated reserves at a faster pace than during the period preceding the crisis, thereby financing US deficit. It still makes sense to maintain reserves in the same currency as that of foreign debt and foreign trade. Such funds are employed to lighten the debt, ease trade flow and intervene in foreign currency markets.

The strengthening of the dollar could be a short-term phenomenon. It might be argued that the vast amount of securities issued by the US financial market began to erode confidence in the dollar and US government securities. Over the next few years, the United States will be forced to issue large quantities of debt, in part to finance the imposing bailout and stimulus packages approved in 2008-2009. With an evident deceleration in financial globalisation, this could create significant problems for the United States in financing its budget and trade deficits. After the Second World War, the reason most allies and trading partners financed American debt was in part, political: it was the only superpower facing down the Soviet bloc. The United States drew support, even if only as a mechanism for trading military and economic protection and the dollar stood dominant Such motivations have waned.

It is likely that this will all lead to a gradual fading of the dollar’s predominance in reserves and international trade. Rapidly growing emerging economies in the midst of increasing global multipolarism will tend to increase foreign exchange reserves and should consider alternatives. The euro and Europe are the most natural beneficiaries of this diversification process. In 2008, 45% of international securities were issued in dollars, compared with 32% denominated in euros.[21] According to the Bank for International Settlements (BIS),[22] in 2007, 86% of all international transactions were carried out in dollars, compared with 38% in euros.[23] In April 2008, according to the

[21] IMF, Currency Composition, op. cit.; See, R. Moghadam, Reserve Currencies in the Post-Crisis International Monetary System, September 24, 2009 by iMFdirect; and L. Goldberg and C. Tille, Vehicle Currency Use in International Trade, in Journal of International Economics, Issue 76, Vol. 2, pp. 177-192, December 2008.

[22] BIS, Triennial Survey of Annual Trade, 2007.

[23] The total for all currencies comes to 200% since each transaction involves two currencies.

IMF, 66 countries used the dollar as the reference currency for their exports, compared with 27 that used the euro.[24]

Central banks tend to prefer currencies that do not devalue due to inflation, but even more they choose currencies that can be easily monetized for use in open market operations. This latter characteristic depends on the liquidity and depth of the market for government securities issued in that currency. The US securities market is still the largest government securities market in the world: holding almost two-thirds of the reserves of central are dollar denominated, while, sterling and the Swiss franc only account for 2% and 1%, respectively.

Therefore, the only alternative to the dollar in the near future is the euro. The European Union's GDP exceeds that of the United States. It has a stringent and effective inflation target. The Stability and Growth Pact has contributed to the stability of public finances. Though, to date, only 16 EU member states have adopted the euro and differences between the securities of the various member states exist - reflecting the fact that the national economies are not always in step. Larger markets, like Italy, are affected by a certain degree of economic and political instability, but the importance of the euro as a reserve currency is bound to increase, especially in the countries that border continental Europe, such as the Mediterranean-basin countries and Russia. As euro-denominated trade increases, the euro reserves of the central banks of the nearest countries will grow. Between 2008 and 2009, the euro reserves of the central bank of Russia increased from 42 to 47% of the total, while its dollar reserves fell from 47 to 41%.[25]

Diversification of China's reserves will have a much greater impact. It is estimated that 60% of the official reserves of the Chinese central bank are currently in dollars, and this dependence is causing concern. A sudden change of tack could cause the price of American securities to collapse, with a negative impact on both China, whose reserves would be devalued, and the United States, which would be forced to revalue them. It is therefore likely that the Chinese will adopt a strategy of gradual diversification that will

[24] IMF, Currency Composition, op. cit..

[25] L. Goldberg and C. Tille , op. cit., p. 184.

require several decades to complete. While gradual, this - given the volumes involved - is a major change that could impact notably in the short-to-medium term.[26]

Clearly, the creation of a single European sovereign bond market, in the immediate future will pose serious competition for the US market,[27] with increasingly ample room for the euro and therefore, European debt to finance infrastructure and development in Europe.

The market for US federal government securities is around $2,500 billion.[28] The equivalent sovereign European debt would be around 13.5% of the European Union's GDP.[29] This is a relatively modest portion of the total public debt of the EU-27 member states, equal to 61.5% of Europe's GDP in 2008, the European Commission estimates this figure will rise to 72% in 2009 and 79.4% in 2010;[30] however, adequate to make truly significant strategic investments.

3. *The New EU Economic Governance*

The global economic and financial crisis has wiped out years of EU economic and social progress and nowadays Europe faces big long-term challenges both at economic and social level. Therefore, it's important to create an European strategy to come out stronger from the crisis and turn the EU into a smart, sustainable and inclusive economy, delivering high levels of employment, productivity and social cohesion. In particular, the Union has to work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of

[26] It is no coincidence that for some time now there has been discussion of the possibility of transferring a part of the world's reserves into IMF Special Drawing Rights, which are based on four currencies (dollar, Euro, yen and pound sterling). This marks a return to the "bancor" idea proposed by Keynes after the First World War.

[27] "The current global economic crisis has encouraged talk of issuing Euro-area bonds with the backing of the entire set of Euro-area members, including, most importantly, Germany. If this were done on a significant scale and if this debt were to replace the member states' national debt securities, the Euro area would possess a market with roughly the uniformity and liquidity of the United States' Treasury market. But such radical fiscal federalism is not something to which the German government, among others, is likely to agree.." (B. Eichengreen, *The Dollar Dilemma*, in *Foreign Affairs*, September/October 2009, p. 58).

[28] The US federal debt is forecast to be $2,553 billion at the end of 2009 (*Economic Report of the President*, send to the United States Congress in January 2009, Table B-78, p. 377), therefore about €1,670 billion (at the prevailing exchange rate on 4 November 2009).

[29] The GDP of the EU-27 (2008) came to €12,506 billion (Eurostat figures).

[30] European Commission, *Public Finance in EMU 2009*, May 2009.

the quality of the environment (art. 3 TEU). Moreover, the Union is called to achieve long-term goals described in Europe 2020, the new strategy for jobs and smart, sustainable and inclusive growth, that sets out a vision of Europe's social market economy for the 21st century[31].

Europe will continue to benefit from being one of the most open economies in the world, influence global policy decisions and compete with other developed or emerging economies only if acts jointly and collectively, as a Union. So, Europe has to work in closer collaboration with Member States to take enhanced coordinated action, in particular in the economic field. In fact, the recent crisis, followed by the recent euro-area debt crisis, has underlined the interdependence of the EU's economies and the need for reinforced coordination of national economic policies, in particular within the Economic and Monetary Union (EMU).

Stronger EU economic governance (on the basis of art. 119-138 TFEU) is fundamental for a credible and effective EU exit strategy, to deliver the results of Europe 2020 and to avoid too many differences in national economic policies that could undermine an homogeneous growth in the EU as a whole. In a short period of time, EU has created a new EU economic governance based on three main pillars: 1) a reinforced coordination of national economic and fiscal policies in the EU, on the basis of the Treaties and the recent Commission proposals of reform; 2) a new fiscal policy, based on the revision of the Stability and Growth Pact (SGP) and on a stronger budgetary surveillance as well as broader macroeconomic surveillance. This should contribute to EU long-term growth and sustainability of public finances; 3) new mechanisms to manage the debt crisis of the Member States in the euro-area, in order to ensure and keep the stability of the Economic and Monetary Union. In this context, it’s also important to underline the changing role of European Central Bank (ECB), committed not only to fight against inflation, but also to defend the Euro stability[32].

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[31] COM (2020) 3.3.2010, Europe 2020. A strategy for smart, sustainable and inclusive growth.

[32] According to Italian Minister of Economy and Finance, Giulio Tremonti, in his *Lesson at the Walter Eucken Institut*, 20th July 2010, "after the crisis and under the pressure and stress of the crisis, it is configuring a new EU architecture, more political than economic, based on four pillars: the ECB, the SVP (Special Purpose Vehicle), the "new" Stability and Growth Pact and, finally, a common policy of austerity. The first two pillars have a function of national defence, while the latters have a function of internal discipline".

In the recent Report of the Van Rompuy Task Force of 21th October 2010, *Strengthening economic governance in the EU*[33], there are the main policy recommendations and concrete proposals agreed and suggests further steps for their implementation. It aims at achieving a "quantum leap " in terms of more effective economic governance in the EU and the euro area, to be implemented in five main pillars: (i) fiscal discipline, notably through a stronger Stability and Growth Pact (ii) broadening economic surveillance to encompass macro imbalances and competitiveness (iii) deeper and broader coordination (iv) a robust framework for crisis management; (v) stronger institutions and more effective and rules-based decision making.

In strict connection with the new EU economic governance, there is the need to discover a new industrial policy to establish a solid and dynamic industrial base contributing to the growth of the European Union and sustains its economic and technological leadership in the era of globalization, as underlined in Europe 2020 strategy. Like stressed by Mario Monti, "the word industrial policy is not more a taboo and Europe should remain confident that its single market is its first and best industrial policy. Thus, it would be recommendable to develop a new approach to industrial policy which builds on a mutually reinforcing relation with single market and competition rules"[34].

In order to pursue these economical and industrial objectives, on the basis provided by the Treaties, the Union has to mobilise all of the existing instruments, policies and legal acts, as well as financial instruments, described below in paragraph 7. In particular, the new and stronger EU economic architecture may create the conditions for a new EU sovereign debt, strengthening the capacity to leverage tools nominated in Euro, with EU endorsement.

[33] The Task Force was established by the European Council of 25-26 March 2010 with the mandate to present, before the end of this year, the measures needed to reach the objective of an improved crisis resolution framework and better budgetary discipline, exploring all options to reinforce the legal framework. The European Council of 17 June 2010 agreed with the first orientations from the Task Force and looked forward to their Final Report of 21 th October of this year.

[34] Mario Monti Report, A new A new strategy for the single market of 9th may 2010.

The new framework for debt crisis management for euro area Member States

The Greek debt crisis showed that a robust framework for crisis management within the euro-area is needed and is a necessary complement to the instruments for surveillance, prevention and adjustment discussed above. Indeed, financial distress in one Member State can jeopardize the macro-financial stability of the euro-area as a whole. Thus, a clear and credible set of procedures for the provision of financial support to euro-area Member States in serious financial distress is necessary to preserve the financial stability of the euro area in the medium and long term.

Financial assistance to an euro-area Member State in the form of lending– as opposed to assuming its debt - is not in contradiction with Article 125 TFEU and the policy programme and conditionality should be set within article 136 TFEU.

On 9-10th May 2010, based on a proposal of the Commission, the Ecofin decided on the establishment of a temporary European Financial Stabilisation Mechanism (EFSM) to deal with the immediate needs of the crisis in order to preserve the financial stability of the EU. This mechanism will be financed through two complementary sources: the first can mobilize a total volume of up to € 500 billion in accordance with the procedures established in a proposal of Council Regulation based on Article 122(2) TFUE that foresees financial support for Member States in difficulties caused by exceptional circumstances beyond Member States' control. A volume of up to € 60 billion is foreseen and activation is subject to strong conditionality, in the context of a joint EU/IMF support, and will be on terms and conditions similar to the IMF. The mechanism will operate without prejudice to the existing facility providing medium term financial assistance for non euro area Member States' balance of payments. Three Rating Agencies has recently assigned AAA to this Mechanism.

In addition, the euro-area Member States stand ready to complement such resources through a Special Purpose Vehicle – the European Financial Stability Facility (EFSF)[35], whose root could be the associated with the European Investment Fund (EIF), as thought by Delors' in the Commission Communication, *From the Single Act to Maastricht and beyond: the means to match our ambitions* (1992).

[35] The Agreement was concluded on 7th June 2010 between the 16 "euro-area Member States" or "EFSF Shareholders" and European Financial Stability Facility ("EFSF"), created in the same day as a "*société anonyme*" incorporated in Luxembourg (a public limited liability company).

According to the intergovernmental agreement recently concluded between the Euro Member States and the SPV, this Fund would borrow using financial guarantees of the participating Member States up to EUR 440bn. In particular, the EFSF may make loans to euro-area Member States, by issuing or entering into bonds, notes, commercial paper, debt securities or other financing arrangements ("Funding Instruments") backed by irrevocable and unconditional Guarantees issued by the euro-area Member States ("Guarantors"). Thus, the Fund could be an instrument for the issuance of E-bonds, better described in paragraph 7, that could make more manageable the debt crisis of euro Member States.

The IMF will participate in financing arrangements and is expected to provide at least half as much as the EU contribution through its usual facilities in line with the recent European programmes.

The Fund would be activated only if a Member State were to be unable to raise sufficient financing from the markets. This mechanism largely respects the basic principles for a permanent robust crisis resolution mechanism. Therefore, the Commission considers that the first priority must now be to make this mechanism fully operational. Based on this experience, the Commission intends to make a proposal for the establishment of a permanent crisis resolution mechanism for the medium-to-long term.

4. *The need of Long Term Investors*[36]

Long-term investments (LTIs) play a key role for both the real and the financial side of the economy. As for the real economy, they usually have a positive impact on economic growth through two main channels. The first one is a direct channel and is related to increases in productivity, since LTIs are mainly targeted to building infrastructures, investing in R&D, setting up new business, or adopting better technologies. All these activities are generally productivity-enhancing. In contrast, short-term investments are

[36] For more on this issue, see: F. Bassanini and E. Reviglio, *New European Institutional Long Term Financial Instruments for a Sustainable and Balanced Growth*, now in *Astrid Rassegna*, no. 17/2009, www.astrid-online.it/rassegna/06-10-2009/Bassanini_Reviglio_Goteborg_-riimpag.pdf); Id., *Tempi maturi per un debito sovrano Europeo*, in *Il Sole 24 Ore*, 7 October 2009 (see www.astrid-online.it/Riforma-de/Rassegna-Bassanini_reviglio_Sole24Ore_prox_pubbl.pdf; Id., *Long Term Investments The European Answer to the Crisis Towards a New European Policy of Value Creation for Future Generations: the "Marguerite" Network*, paper presented to the *Paris Conference for Long-term Value & Economic Stability*, Paris, June 2009, now in *Astrid Rassegna*, no. 12/2009.

more oriented to maintain current business capacity. The second channel consists in an indirect mechanism, which is linked to the countercyclical effect of LTIs. In fact, they stimulate the economic activity by mitigating output volatility, which is commonly associated to negative effects for growth.[37]

LTIs may therefore induce economic growth, employment and global stability. These kind of investment also contribute to the improvement of the business and consumer environment, by modernizing the interconnection framework, by lowering the transport costs, and by supporting the green economy, among other things. However, their potential returns are expressed only after several years, due to the time horizon of project's realization. What is more, since LTIs face a higher liquidity risk, in presence of credit constraints they can weaken the solidity of the industrial and banking sector. With this respect, developed financial markets reduce the potential losses due to risks of liquidity.

Looking at the financial side of the economy, LTIs are characterized by a low reliance on short-term market liquidity, due to stable resources, often made of regulated or guaranteed deposits, long-term savings products or long-term borrowing. They generate stable cash flows over longer periods and financially sustainable long-term risk-adjusted rates of return. The investors have a robust capital base, which relies mainly on reserve accumulation and enables them to absorb short-term fluctuations in financial markets (i.e. by drawing on reserves in bad years and feeding them in good years).

Long-term investors comprise major financial institutions financing economic development, plus sovereign wealth funds, pension funds, public retirement funds, insurance funds, etc. These kind of investors do not generally seek speculative internal rates of return or strong capital gains, due to the clear social responsibility that they usually have in their mission. They are willing and capable to keep in their books long-term assets and liabilities, spreading risks between generations.

Main characteristics of long-term investors are: the ability to retain assets longer than other market players, even in crisis periods, playing in this way a counter-cyclical role on financial markets; investments in - often illiquid - capital or debt instruments that yield a

[37] See, for instance, the works by P. Aghion, D. Hemous, and E. Kharroubi (2009), "Credit Constraints, Cyclical Fiscal Policies and Industry Growth", mimeo.

profitable return in the long-run, such as those issued by companies operating in sectors like general interest utilities, infrastructures, innovation projects, renewable energies, and so on; liabilities that differ in quality from those of other financial investors; investments that are typically carried out with performance and risk targets calculated on a long-term basis.

Long-term investors may play a key role in sustaining and attracting capitals for strategic investments. According to recent estimates by the French Council of Economic Analysis (2010), the weight of the potential long-term investors is equal to about 60% of world GDP and more than 40% of the stock markets.[38] In 2009, Caisse des Dépôts (CDC), Cassa Depositi e Prestiti (CDP), the European Investment Bank (EIB), and KfW Bankengruppe created the Long-Term Investors Club (LTIC). The Club aims at bringing together major worldwide institutions with the common identity as long-term investors. At the end of 2009, the assets managed by the LTIC members were equal to 1.3 billions euro. In the near future, these figures could easily reach the value of 3 billions euro, by taking into account the assets of those institutes that are requiring to join the Club.

International capital flows can match the exit-strategies policies based on strong investments in infrastructure (see for instance the Obama's infrastructure plan and the EU "2020" strategy). Thus, we expect that the global demand for infrastructure will grow rapidly in the next years. World demand for investment in energy, the environment and infrastructure is set to boom over the next few years.[39] In the energy industry, capital expenditure between now and 2030, recently forecast at $26 trillion (in 2008 dollar values), corresponds to an average of $1.1 trillion (1.4% of world GDP) per year.[40] Demand for investment in energy generation will account for around 53% of the sector's requirements. Around half of worldwide investment will be concentrated in the emerging economies, where demand and output will be fast-growing.

The World Bank estimates that, in Europe, €40 billion will be invested annually in new infrastructure. An additional €60 billion will be required for maintenance and replacement of existing infrastructure (mainly in energy generation, telecommunications

[38] See table 3.

[39] Unless otherwise noted, data for this section have been drawn – and partially reworked – from the European Commission, Working Group "2020 European Fund for Energy, Climate Change and Infrastructure (Marguerite)", *Report to the ECOFIN Council*, Brussels, 19 June 2009.

[40] EIA-OECD, *World Energy Outlook*, October 2009.

and transport). The Centre for European Policy Studies recently estimated the overall cost of transport and energy infrastructure needed solely to tackle climate change-related issues in the European Union at around €50 billion per year over the next 40 years.[41]

A recent report by the European Commission offered an estimate of the overall costs of Trans-European Transport Network (TEN-T and TEN-E) projects:[42] Transport requirements assessed at around €900 billion (between 1996 and 2020), of which €400 billion had already been spent by the end of 2007, with a further €500 million to be spent by 2020. Priority projects alone will cost an estimated €400 billion between 1996 and 2020, of which around €130 billion had already been invested by the end of 2007, with the remainder of about €270 billion due to be spent by 2020. The European Union will have to invest at least €30 billion in energy infrastructure by the end of 2013 (€6 billion for electricity transmission, €19 billion in gas pipelines, and €5 billion in liquefied natural gas terminals) in order to achieve the priorities outlined in the Trans-European Energy Network (TEN-E) guidelines. Estimated costs fall between €700 million and €800 million annually to connect new renewable energy plants.[43]

Clearly, it will be difficult to fund investments of this size solely from public resources, particularly with European countries' debt significantly raised in the wake of the financial crisis. More capital must come from private investors in Europe and public sources in countries that are running financial surpluses. The issue of the forms and instruments required to channel such capital into long-term investments in infrastructure is a key element of recovering from the recession and developing a model for sustainable and balanced world economic growth. Given the structural constraints on public finance in many industrialized economies, new long-term financial instruments capable of attracting private capital would present an enormous benefit in lightening the burden on public finance and future generations maintaining direct public investment in fixed and human capital.

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[41] Centre for European Policy Studies (CEPS), Financial Impacts of Climate Change: What scale of required resources, 2008.

[42] European Commission, *Trans European Networks: Towards an Integrated Approach*, Communication 135, 21 March 2007.

[43] According to a market study commissioned from McKinsey by the working group responsible for the "Marguerite, 2020 European Fund for Transport, Energy and Climate Change" in May 2009 (see herein), the European market in which the Fund is involved (transport infrastructure, energy grids, renewable energy and climate change) is estimated to be worth around €30 billion annually.

Bringing together the demand for long-term, low-risk financial investments, and the demand for infrastructure financing creates an opportunity to rebound from crisis. This solution would sustain the vast future demand for new infrastructure while simultaneously assisting to recover the world's financial markets. In this manner, investors also make major contributions to long-term economic and social planning, and become key allies of global policymakers in their effort to correct imbalances generated by the crisis and restore economic and financial stability – both in the short term and for future generations.

5. *A New Regulatory Framework to Foster European Long-Term Investments and Investors*

At European level, there is a vast debate concerning the development of new regulatory framework to foster long-term investments and to reduce the main impediments and improve incentives for long-term investors (financial institutions with a public mandate but also private investors, including pension funds).[44] Indeed, a new EU regulatory framework is fundamental to attract private financial resources, including those of European savers as well as non-EU foreign investors, to be allocated in EU strategic investments, such as new infrastructures and renewable energies. In a period of negative constraints for public finances, there is a strong need to establish the conditions for greater financial stability, which specifically require the development of a stable investor base.

The Europe's legislative agenda offers numerous opportunities to include the specific features of long-term investors into a new regulatory framework that should be based on: a) revisions of international accounting standards for valuing assets (IAS 39/IFRS 9), calibration of the Solvency II Directive and revision of the UCITS Directive; b) an European tax framework with a similar treatment for debt and equity financing; c) an

[44] Part of the statement reported in this paragraph are contained in the position paper followed the round table "*Developing a long term investment perspective favouring financial stability and growth*" during the last Eurofi Financial Forum "*Optimizing EU financial reforms for achieving resilience, growth and competitiveness. What priorities? What roadmap?*", Brussels, 27-30 September, 2010.

European framework for Public-Private Partnerships (PPPs). This framework would also facilitate off-balance sheet commitments for public authorities and encourage the creation of public guarantee structures to reduce the risks borne by private investors regarding the profitability of long-term infrastructure projects, which can only be taken on by public authorities.

This new EU regulatory framework would contribute to the Commission strategy - Europe 2020 - intended to enable the EU to deliver high levels of employment, productivity, social cohesion and, finally, to exit from the crisis.

Accounting Standards[45]

While the four institutions of LTIs *Club* are currently applying International Financial Reporting Standards, they are generally not subject to regulatory supervision based on the Basel Committee principles.

They are however aware that these principles are likely to be regarded – by market participants and, in particular, by rating agencies - as part of banking best practices and, at least for this reason, to influence their activity to some extent. For instance, historical experience suggests that their capitalization is benchmarked vis-à-vis Basel principles notwithstanding their peculiar regulatory status.

Moreover, they wish to add to the debate with a systemic perspective in order to promote long-term investment in the economy. In fact, LTIs increase their effectiveness when the banking system is ready to leverage their action on long term investment with a complementary attitude. For this reason the four institutions deem that banking regulation should not include aspects that, when applied to a financial institution, hinder its ability to undertake long-term investments.

Generally speaking, the Working Group believes that in an asset-liability management perspective, these proposals do not take into account the specific features of LTIs' liabilities.

[45] In this paragraph are reported the proposal regarding new accounting rules developed within the *Working Group Supervision* of the LTIs Club.

LTIs have high quality financing instruments and less volatile resources than other financial institutions. In case of liquidity crisis, they generally benefit from “flight to quality”.

Therefore, the Working Group underscores that a large amount of LTIs’ financing sources should be considered as renewable whenever conducting a liquidity stress scenario. Moreover, the Working Group deems that other specificities must be taken into account when assessing the impact of a liquidity stress. In particular, for project financing credit lines, disbursement is conditioned by technical requirements related to the project progress. These facilities are indeed subject to lower disbursement risk than the one of classical banking revolving credits.

The Working Group is concerned by the potential pro-cyclical effects of some Basel Committee’s proposals, which could be at odds with long term management goals. Indeed, the inclusion of unrealised gains and losses in the capital base, the deduction of deferred tax from the capital base and the additional capital charge for the counterparty risk (related to the evolution of credit spreads) would induce procyclicality.

The second important point concerns the way participations are treated. Namely, the deduction of minority interests from the capital base and the deduction of the capital invested in other banks, financial institutions or insurance companies could generate a disadvantage for long term investments. The agreements of the Group of Governors and Heads of Supervision on the reform package on July, 26, 2010 indicate just a very small relief on that point, i.e. only minority interests in a subsidiary that is a bank will be partially recognized.

Lastly, it is important to emphasize that the leverage ratio should not become part of Basel’s first Pillar, as it is merely a ratio of equity over nominal liabilities without any risk-weighting. As it is explicitly intended to be a non-risk based measure, it should be part of supervision but only as a Pillar two measure.

As many other long-term investors, our long term financial institutions welcomed G20 conclusions calling for a valuation of financial instruments based on their liquidity and investors’ holding horizons, taking into account valuation uncertainty.

However, the standard on financial instruments (IFRS 9), as published in November 2009, and the related proposals of the International Accounting Standards Board (IASB) on impairment and hedge accounting do not give enough prominence to the investor's holding horizon criterion.

Specifically, with regard to "Classification and measurement of financial instruments", in order to achieve a true and fair representation of LTIs' business model, there is a need for an alternative to the classification requirements of IFRS 9. Accordingly, the Working Group suggests to introduce a third category for financial instruments that are held as investments in a medium or long term perspective besides the amortised cost and fair value through profit or loss categories. Financial instruments included in this category would be measured at the lowest between the acquisition cost and value in use.

Fiscal Incentives

In many European tax systems, the long-term investments are disadvantaged when compared to the financial short-term investments and /or with respect to debt finance. These discriminatory disincentives should be abolished, because any disadvantageous tax treatment of equity finance, compared with debt finance, may tend to hold down profitable investments.

The Allowance for Corporate and Project Equity (ACPE) proposed by the Eurofi Action Plan would be a positive step for granting an equivalent treatment to equity with respect to debt financing. The ACPE applies a nominal interest rate to a project or company's total equity capital and reduces the tax base. As a consequence, the effective tax rate can be greatly diminished, depending on the capital structure (Debt / Equity ratio).

We could also introduce the total or partial deductibility from the company's tax base of an increase in equity finance which is accompanied by an equivalent increase in long-term investments. Such an incentive could be linked to certain specific characteristics of the investment projects which qualify them as long-term initiatives of general interest (see, for instance, the incentives which are granted to the US Project Bonds or awarded to the renewable energy projects). On the other side, financial institutions can be eligible for incentives if they decide to hold part or all of their assets as long-time investments.

Public Private Partnerships (PPPs)

The crisis is placing pressure on public finances in many Member States and, at the same time, makes more difficult to secure long-term private investment in capital intensive projects. Public and private sectors must work together to build new forms of complementarities. The combination of public and private capacities and resources can help investment in EU long-term projects, in particular in infrastructures, sustaining, finally, the process of EU recovery. Indeed, investment in infrastructure projects is an important way to maintain economic activity during the crisis and support a rapid return to sustained economic growth.

As outlined by the European Commission, Public Private Partnerships (PPPs) can provide effective ways to deliver infrastructure projects, to provide public services and to innovate more widely in the context of these recovery efforts. At the same time, PPPs are interesting vehicles for the long-term structural development of infrastructures and services, bringing together distinct advantages of the private sector and the public sector. In addition, at EU level, PPPs can offer extra leverage to key projects to deliver shared policy objectives, such as combating climate change; promoting alternative energy sources as well as energy and resource efficiency; supporting sustainable transport; ensuring high level, affordable health care and delivering major research projects such as the Joint Technology Initiatives. Finally, PPPs offer capacity to leverage private funds and pool them with public resources.

New rules, incentives and common “best practices” for PPPs should be introduced at the EU level as well as the individual States’ level, in order to improve the efficiency of these instruments. In particular, “best practices” and common rules for PPPs and PFIs must be shared at European level in order to improve the efficiency of these instruments. Gradually, these “best practices” should evolve into guidelines and manuals to be jointly utilized by all members of Long Term Investment Club. Within this framework new European regulation might emerge to account for different time perspectives of private and public partners in both PPPs and PFIs. Anyway, It will be important to ensure that the applicable rules are appropriate and supportive while fully respecting the principles of the Internal Market.

In this perspective, it’s interesting the new Commission Communication of 19th November 2009,[46] that aims at creating a supportive Community framework for PPPs designed to meet the needs of citizens, furthers Community goals. According to the European Commission, a PPP group could invite relevant stakeholders to discuss their concerns and further ideas with regard to PPPs. Where appropriate, it will issue guidance assisting Member States in reducing the administrative burden and delays in the implementation of PPPs. In this context, it will explore ways to facilitate and to speed up the attribution of planning permits for PPP projects. It will be important work with the EIB with a view to increasing the funding available for PPPs, by re-focussing existing Community instruments and by developing financial instruments for PPPs in the key policy areas. Moreover, it will be necessary review the relevant rules and practices in order to ensure that there is no discrimination in the allocation of public funds, where Community funding is involved, depending on the management of the project, be it private or public. The Commission proposes a more effective framework for innovation, including the possibility for the EU to participate in private law bodies and directly invest in specific projects, also considering a proposal for a legislative instrument on concessions.

According to the result of the European debate at Eurofi 2010, at the European level, it is desirable to put in place practices such as: a standardised approach for the assessment, and the distribution (including its formalisation) of a PPP's risks between the public authorities and private partners, in addition to a standardised mechanism for reporting on PPP performance that would make it possible to establish a common language with a view to accelerating the establishment of such partnerships from both an industrial and a financial perspective, while helping ensure the financial fungibility of such investments.

6. The New Financial Instruments for Long-Term Investment

The financial crisis has had a significant impact on the capacity of European businesses and governments to finance long-term and strategic investments and innovation projects, considered a priority for the EU growth since the Delors White paper

[46] COM(2009) 615, Mobilising private and public investment for recovery and long term structural change: developing Public Private Partnerships.

on Growth, competitiveness, and employment (1993), to the Lisbon Agenda (2000) and, more recently, in Europe 2020 Strategy (2010) and in Mario Monti' Report, *A new strategy for the single market* of 9th may 2010.

As underlined in these documents, long-term investments are decisive for the EU growth, especially in the field of infrastructure, like Trans European Networks (TNTs), whose importance is also stressed in the Lisbon Treaty (art. 170-171 TFEU).

In a period of sovereign debt crisis, the key issue for Europe is how to raise new resources for medium and long term investments of European importance. Thus, innovative financial instruments at EU level are necessary to support the needed investments as well as enhancing a legal framework for the use of market-based instruments, including public-private partnerships (PPPs) as seen above.

The European Investment Bank (EIB) and the European Investment Fund (EIF), managed by the former, may play a key role in financing long term investments and designing new financing instruments, in line with the new EU institutional framework. In fact, art. 309 TFEU lays down that the task of the European Investment Bank is to contribute, by having recourse to the capital market and utilising its own resources, to the balanced and steady development of the internal market in the interest of the Union. For this purpose the Bank, operating on a non-profit- making basis, grants loans and give guarantees which facilitate the financing of the following projects in all sectors of the economy. In carrying out its task, the Bank facilitates the financing of investment programmes in conjunction with assistance from the Structural Funds and other Union Financial Instruments.

New architectures for equity funds, project bonds, debt instruments and, more generally, credit-enhancing initiatives must be considered. New regulated vehicles must be created in order to improve the liquidity of these instruments maintaining their typical risk-return profile. If successful, new financial instruments will be an interesting long-term investment opportunity for institutional investors such as pension funds, insurance companies, SWFs, as well as households.

The Effects of the Financial Crisis on PFI Initiatives and the "Marguerite" Network

Traditional sources of senior debt for infrastructure and energy projects have contracted sharply in global recession. Capital markets supply insufficient debt financing to these sectors, owing to a shortage of transactions backed by monoline insurers and low investor appetite for unguaranteed project bonds.

Obtaining long-term bank credit is also especially challenging at present due to liquidity and capital constraints on major banking groups. Syndicated loan volumes are down as are amounts banks will commit to individual transactions.

As financial institutions are increasingly risk-averse, leveraged financing structures require far more equity capital than in the past. It is difficult to get major infrastructure projects off the ground without the involvement of public equity capital or long-term public institutional investors capable of attracting private capital. On the other hand, emerging sectors such as strategic investments in renewable energy and environmental infrastructure are expected to be an increasingly attractive asset class for banks and capital markets.

At the September 2008 Ecofin gathering in Nice, the Italian Minister for the Economy and Finance proposed to support the European Economic Recovery Plan as a better alternative over any exit strategy plan involving the already troubled EU budget. The plan establishes major equity funds, fuelled by financial institutions, for channeling private capital, households' savings and public funds from non-European countries in search of diversification opportunities.

After the approval of Ecofin, the European Commission and the EIB, joined by representative European long-term institutional investors - Caisse des Dépôts et Consignations (CDC), Cassa Depositi e Prestiti (CDP), and Kreditanstalt für Wiederaufbau (KfW) – started developing and implanting the project. These market-oriented public institutions (most in private-law form) have significant technical skills and forward-looking dedicated interest in public welfare.

The working group's three month study delivered a proposal, adopted by the European Council on 20 December 2008. In 2009, an *ad hoc* committee of technical experts from the EIB, CDC, CDP and KFW started setting up the "Marguerite, 2020 European Fund for Transport, Energy and Climate Change". The ICO of Spain and PKO of Poland subsequently joined the project, making for six founding members. The Fund was established in Luxembourg on 12 November, and the first meeting of its governing bodies was scheduled for 3 December in Brussels. The European Commission granted €80 million to the Fund, less than the amount invested by the other founding members, but of great symbolic importance, as it is the only contribution drawn from the resources of the EU public budget. Other potential investors that have declared an interest in joining the operation include the British Treasury (as a sponsor of private pension funds), Bank Polski (BGK) of Poland, the Bulgarian Development Bank, a Slovenian institution, Caixa of Portugal, and an Irish institution. Such investors will have smaller stakes, and will not be represented on the Fund's governing bodies.

Under the original plan, the Fund was to be significantly larger, with assets of up to €10 billion. The founders decided to follow a more prudent route and begin with a smaller initial closing: setting the maximum at €1.5 billion. Nevertheless, as the months have passed, the view that the maximum can be raised significantly, indeed, as much as the ceiling initially envisaged, has gained ground. At the same time, there is increased awareness that the demand for financing strategic infrastructure projects of European interest may exceed the €30 billion per year estimated in the study that the Fund commissioned from McKinsey. If the initial project is successful, expansion or set up of similar funds could soon become irresistible.

The working group also explored the option of deploying other financial instruments that could potentially help enhance the Fund's activities and increase its resources. Two such "market-conform" tools – project bonds and guarantee systems – are discussed below.

It is estimated that over the next few years, due to multiplier and support effects for private funds, the Marguerite will mobilize investments in the order of €30 billion - €50 billion in the European energy and infrastructure sectors. The geographical scope of the investments should span all 27 EU member states. Priority sectors being: 1) TEN-Ts and other associated transport infrastructure; 2) TEN-Es, including electricity, gas, LNG and oil pipelines, grids, interconnection systems and storage; and 3) renewable energy generation (including photovoltaic, solar and wind). These sectors/projects will have solid IRR and satisfactory Economic Rates of Return (ERR).

The Fund will be an investment vehicle for long-term institutional investors from both the public and private sectors. Mainly investing in equity stakes, primarily in new Greenfield projects, but as noted above, the Fund will also have associated debt facilities managed directly by each individual institution. These additional facilities could potentially mobilize many billions of euros in added resources.

In brief, the Fund will to all effects be "market oriented", but distinguished from traditional private equity funds by: (1) seeking "non-speculative" returns; (2) investing with long-term horizons; and (3) gathering significant institutional endorsement helmed by the European Commission among the founder members.

The 1.5 billion 'Marguerite' Fund proves "reinforced cooperation" in European financial sector and stands prototype for a "family of European funds for growth" to support the Lisbon Agenda's ambitious objectives. It may foster the emergence of a new broad cooperation of long-term *institutiona*l investors – a "European Super Fund" – a solid buttress for strategic infrastructure.

European Single Project Bonds[47]

Potential alternatives exist to raise funds for infrastructure, within given limits imposed by current economic conditions noted earlier. The resulting investments could prove to be an attractive opportunity for pension funds, insurance companies, sovereign wealth funds and households.

Single project bonds for energy or transport programs could be particularly important at a time when leverage is severely diminished. Following the collapse of monoline insurers toward the end of 2007 as well as of several securities' markets.

Project bonds sponsored by the Marguerite Network would be particularly appealing. The "reputation premium" generated by the European Commission's participation and

[47] On 25 September 2008, the Vice-President of the European Commission with responsibility for transport policy, Antonio Tajani, met with the EIB President Philippe Maystadt and his Italian and Greek Vice-Presidents to investigate potential strategies for maximizing the EIB's involvement in funding major transport infrastructure projects. A decision was taken to set up an informal working group consisting of representatives from the Commissioner's Cabinet, the Directorate General for Transport and Energy, and the EIB, with the objective of studying new tools for financing TEN-T projects and facilitating participation by private investors. For the most part, the proposals presented in this and the following section have been taken (in some cases verbatim) from an informal memorandum drafted by the working group in the summer of 2009.

the prestige of the other founding shareholders would surely lower costs, raise the credit ratings of the securities involved, and create an asset class attractive to investors seeking to match their liabilities with long-term, fixed-income assets, including European households and foreign sovereign wealth funds diversify. With well-prepared projects, funds raised directly, would not officially deplete public accounts of either the European Union or individual member states.[48] The Marguerite Network, is key in its very essence: providing track time evidence crucial to project bond promoters, as a new generation instrument garnering guarantees and technical support.

In the past, a number of Member States have urged greater Commission involvement in ownership of the TEN-T and TEN-E projects, and so called for the issue of Eurobonds to enable the dedicated EU budget. Discussed further on, an amendment to the European Treaties is necessary before the Commission may dip into the capital market. Such a path promises to be sufficiently challenging so as to render the route relatively impractical in the immediate future.

In contrast, European single project bonds issued directly by project sponsors create a fast and attractive instrument. Due to the recent difficulties experienced by monoline insurers, no such securities currently exist on the market. Prior to the crisis, a significant part of the project bond market was “wrapped”, or, in other words, secured with AAA monoline guarantees, and donned high ratings. Attractive dressings appealed to institutional investors seeking assets with ratings purportedly making the requisite grade due their long-term and fixed-income liabilities.

Guarantee Schemes and Project Bonds

The Marguerite Network could provide debt service guarantees to cover project bonds. Under the current regulatory framework, guarantees are an acceptable alternative to loans provided to cover profiles at risk. Bonds issued for individual projects, if European Super Fund-sponsored, would naturally adopt the Network’s credit rating.

[48] If the funding is issued by a “market unit”, even if that unit is 100% owned by the State or some other public sector entity, and if, thanks to an appropriate financing structure, at least two out of the three risks that characterize a PFI project (construction, traffic and tariffs) are transferred to the market, then in compliance with the ESA-95 accounting rules, this debt is not included in the national public debt, valid for compliance with the criteria of the Maastricht Treaty and the Stability and Growth Pact.

Sporting solid reputation and technical expertise in "assembling" PPP projects, and an added monoline guarantee to security, any Marguerite recommended instrument, with a high rating and low cost, is certain to attract investors. In the event a project's full funding were not covered by bonds, banks may then invest. Single project bonds promise: (a) non-encumbrance on national budgets (or more pointedly on Network members' accounts – other than the cost of the guarantees); (b) facilitation of projects with long-term goals – as of late left outside market means; (c) a "market-conform" instrumental attraction (d) no crowding-out effect - as a portion of debt may be bank-designated. Note the above-proposed is similar to the proposal introduced/presented in Obama's stimulus plan,[49] tailored to fit Europe

Projects financed by issuing securities on capital markets and guaranteed (by Marguerite) promise studied structure and regular, reliable returns. Cases presenting technologically complex construction or other intricacies at issue, will most likely depend on availability of payment cash flow, rather than asset use support.

In the framework of PPPs, European Commission is working on the development of the two Trans-European Transport Network (TEN-T) instruments to be managed by the EIB, which will be based on risk-sharing arrangements between the Commission and the EIB:

1) Loan Guarantee instrument for TEN-T projects (LGTT). The LGTT is a guarantee facility that facilitate greater private-sector involvement in the financing of TEN-Transport infrastructure. LGTT is designed to guarantee revenue risks during a limited period following construction of TENs projects, notably under a PPP structure. Individual LGTT guarantees are available through the EIB. In total the LGTT facility is expected to support 25-35 TEN-T projects by 2013.

[49] In the United States, as in the European Union, the new Administration is seeking to counter the recession with economic stimulus measures that include a significant commitment to new investment in public infrastructure. The stimulus package provides for the issue of new types of project bonds, which are accompanied by significant direct tax relief for the net interest accrued on the bonds. For example, the "Recovery Zone Economic Development Bonds" are to be issued to finance public infrastructure projects or the construction of projects to deliver public services, as well as for projects connected with employment growth and career development. The "Qualified Energy Conservation Bonds" provide $2.4 billion for projects related to renewable energy and building maintenance to meet energy-efficiency and environmental standards. The new stimulus package also includes project bonds for rail transport, as well as $1.6 billion in "New Clean Renewable Energy Bonds" to finance biomass and hydroelectric power generation.

2) Risk-Sharing Finance Facility (RSFF). The RSFF is an innovative credit risk sharing scheme jointly set up by the European Commission and the EIB, as well as the financing instruments under the Competitiveness and Innovation Programme (CIP). It will support higher-risk research, technological development and demonstration projects through loans and guarantees.

European Joint Undertakings[50]

Instruments envisaged to achieve Lisbon Agenda objectives, European legislative designs encourage exercising technological research and development programmes. The instrument named "Joint Undertaking", has attracted little attention and usually sits unemployed. According to Article 187 of the Treaty on the Functioning of the European Union (TFEU), the Union may "set up Joint Undertakings or any other structure necessary for the efficient execution of Union research, technological development and demonstration programmes". Related decisions, to be taken by the Council, acting on Commission proposals after consulting the European Parliament and the Economic and Social Committee, as outlined in Article 188 of the TFEU. It is also possible to establish "European Joint Undertakings" through "reinforced cooperation". Recently these provisions allowed the European Union and the ESA to implement the Galileo programme. The first Joint Undertaking, Euratom (1957), was subsequently reinforced in EEC Treaties (1987 and 2001).

Galileo exemplifies the potential of this European governing tool. Form is outlined and functions are clearly defined. Founded when Europe, forced to rely on the United States' GPS system during the Balkan crisis in 1999, realized an urgent need for an integrated European satellite system. The Galileo Joint Undertaking was established in 2007 to govern the creation of a system, by then to be principally dedicated to civilian purposes. The initiative proposed a GPS system in place, by 2013, to deliver five main civilian services for the security of Europeans. Together the European Parliament and Council budgeted €3.4 billion for the 2007-13 term, designed a system of governance and structured an implementation of the programme.

[50] See Domenico Moro, L'impresa comune (ex art. 171, Trattato CE) come strumento di una politica Europea di investimento nelle reti trans Europee, in L'Europa dei progetti – Imprese, innovazione, sviluppo, 2007, pp. 201-249, and references contained therein.

The European Commission acts as project manager and contracting authority, while the European Space Agency (ESA) serves procurement and design. Together, these founding partners, provide security, continuity and technical support. Potential future partners might include the EIB, European or international private companies or the non-European nations such as China, India or Israel.

The European Joint Undertakings sets a historical precedent similar to the United States government's "Federal Government Corporation", a mechanism geared to raise and combine public and private capital needed to spur national growth, strengthen depressed regional economies, or support services necessary for public welfare which the private sector was then unable to permit.

The "Federally Chartered Corporation", provides services of combined socio-economic significance. From water management to postal service, either wholly or partially owned by the federal government, though never consolidated in federal government accounts.

If we were to compare the US context with what is now coming about in Europe, we could equate wholly public federally chartered corporations with the Community's 'Executive Agencies' and the mixed public/private variety with Joint Undertakings, and, should we wish to adapt the terminology to the European regulatory context, we could call them 'Union Corporations' or 'Community Corporations'. In any event, for the purposes of Europe's economic policy authorities, the balance sheets of these enterprises would not be included in the accounts of the individual member states or, without changes in Eurostat rules, even in the accounts of the European Union.

Joint Undertaking' purpose, defined in the TFEU, is to program "efficient execution of Union research, technological development and demonstration " This role is well-cast to fund and implement strategic infrastructure projects that feature a high level of research or technological innovation and development fund; adapted projects abound in the energy sector alone: renewable energy, energy savings, waste reduction in energy transport and distribution, energy storage, and the development of fourth-generation nuclear power plants all require investments in basic and applied research and technological innovation – costs fast growing beyond means sustainable by even the largest multinational corporations. A new "European Energy Union Corporation" perfectly fits this project.

Promotion by Euratom, itself a Joint Undertaking, would attract private capital from both the industrial and financial worlds.

If Article 187 of the TFEU remains unchanged, unless existing text is interpreted much more loosely, there are relatively fewer options for Transport. Though a sector commonly considered mature, particular situations could summon. Innovative Projects into play: technically intricate plans requiring complex organisation and unique works, repeatable only in other parts of the world, resulting in an accumulated know-how on which European enterprises could capitalize.[51]

With a minor amendment to Article 187, an acceptable structure also for special transport projects might be created through innovative weavings of European Economic Interest Groupings (EEIGs) or with the European Company, stitched within the framework of reinforced cooperation under Article 329 *et seq.* of the TFEU.

TEN-T projects budget needs nearly €500 billion, of which, high-priority projects claim €280 billion. The European Construction Industry Federation (FIEC)[52] originally proposed a 30-year, 6% fixed-rate loan, with a 10% contribution by the European Community, 20% gained from the private sector, and European participation that varies from 50 to 70%, depending on whether or not member states individually commit 20%. These investments could be financed by one or more Joint Undertakings, if a minor amendment to Article 187 made it practical, or by a European company promoted by the member institutions of the Marguerite Network. In this way, one or more large European transport initiatives could take flight and glide smoothly as Amtrak[53], originally established under the New Deal. The territory might be better adjust to a Joint Undertaking fit if each European Corridor were addressed individually and advantaged by provisions governing reinforced cooperation. “Missing links”, like the transalpine tunnels,

[51] Examples of these types of technological advanced projects are the Brennero and Lyon-Turin primary tunnels.

[52] Fédération de l’Industrie Européenne de la Construction (FIEC), *Propositions de la FIEC pour le financement des infrastructures ferroviaires en Europe*, Brussels, September 2002.

[53] “The decision to opt for a European Track,” Domenico Moro writes, “has another important implication that, although not of an industrial nature, could contribute significantly to influencing public opinion in Europe and, consequently, of Europe’s economic and social forces. Indeed, as the American narrative celebrates “Route 66”, and Amtrak itself, thereby contributing to the strengthening of the American identity, the European Union should, with a grand European plan of environmentally sustainable public works, seek to instil the same enthusiasm among the young generations of European citizens.”, *op. cit.*, p. 227.

might be the best beginnings, because such projects expect delays and are commonly found most difficult to implement. Leaving a part of the corridors independent offers national railway companies shareholder options to be shared with the EU, the EIB, and other long-term investors.

The FIEC study mentioned above proposed that a portion of debt service cost could be financed by a special-purpose tax on the diesel fuel used for road transport. Current European treaties require unanimous approval for the establishment of new European taxes. Therefore, although quite reasonable, the proposal would be difficult to implement. A tax fixed at two cents per litre, would yield €8 to €11 billion per year. The transalpine tunnels' project could extend to 50 years, and significantly reduce annual debt service cost, last estimated by the FIEC as on the order of €15.4 billion per year.[54]

The creation of European Joint Undertakings by applying "reinforced cooperation" could prove beneficial. A required qualified majority, would speed the process: a "qualified group" of member states could participate from the start (as in the case of the euro), and other countries could join at a later date. European Joint Undertakings are corporations under a European Union umbrella. The EIB, European public or public-private banks, and major transportation and energy companies, would have a share of each "contribution", which could easily arrive at several billion Euros. Much of the financing, in form of debt, could attract public and private banks, as well as large, long-term institutional investors (such as pension funds, insurance companies, and sovereign wealth funds, etc.).

It is clear that these projects will only be successful if a significant portion of the necessary funding is provided by European special-purpose funds or taxes, by European public debt, or by a combination of the innovative instruments discussed herein. Public and private enterprises and institutions alone, without public support, would be highly unlikely to sustain the substantial costs of these large, strategically important projects.

[54] Which includes: Priority Project 1. Primary Brennero Tunnel (4.3bn); Priority Project 6. Primary Turin-Lyon Tunnel; and Priority Project 24. Third Pass (4.5bn). It has been calculated that the cost of paying for the works over 50 years at an annual rate of 6% would be smaller than the funds that the EU expects to spend for the Trans-European Transport Network.

Union Bonds

The financial instruments discussed thus far, are advantageous because they do not impact directly on public resources. Not ordinarily funded directly by the European Union's budget or that of Member States, they do not increase general government debt. Drawn on funds from private capital markets and global institutions, or raised through institutional investors and others that lie outside the regular scope of government. Tapped are the substantial savings of European households and significant private and public capital outside of Europe seeking reliable, diverse long-term investment opportunities.

The landscape of instruments that may finance strategic European infrastructure projects is incomplete if "Eurobonds", or "Union Bonds" are excluded.

Unlike project bonds, Eurobonds are actual European sovereign debt instruments. Proposed by Delors[55], and reintroduced by Tremonti, they have met with staunch resistance. More recently, in the Barroso 's speech of 7th September 2010, the head of the European Commission re-launched the idea of Union Bonds for financing long term infrastructure investments, recalling in mind the proposals done by Jacques Delors in the *White Paper Growth, competitiveness, and employment* (1993), in the Commission Communication *Stable money – sound finances. Community public finance in the perspective of EMU* (1993) and in the Tremonti's Action Plan for Growth (2003).

Also Mario Monti, in the Report *A new strategy for the single market* (2010), has underlined the EU needs for Union Bonds, due to the fragmentation of government bond markets, that makes European bond market less liquid than the corresponding US and Japanese ones, resulting in costs for investors, issuers, other debtors and, ultimately, European citizens. Moreover, the issuance of E-bonds would be recommended for a sound financial market integration and for an effective financing of EU public infrastructures in Europe, such as the TENs, that are of transnational relief.

[55]"While Delors was the first to speak of a European investment plan in the communications sector, in research and in the major trans-European networks, as well as of "Union Bonds" as a means of financing such projects, the first proposal to issue such bonds actually dates back to Jean Monnet and the establishment of the ECSC. This is no coincidence, given that redemption of the bonds issued by the ECSC, an institution with legal personality, was backed by the taxes on European coal and steel products. Indeed, Article 49 of the Treaty establishing the ECSC states, "The High Authority is empowered to procure the funds necessary to the accomplishment of its mission: by imposing levies on the production of coal and steel; by borrowing." In the case of European companies, redemption of the European bond could be directly backed by the rates charged to users of the services created or by the license fees for the management of the infrastructure.

Indeed, changing times see public debt in all European countries rising and converging around 100% GDP. Therefore, it is becoming more difficult to present Eurobonds as an “asymmetric” instrument with which countries carrying higher levels of debt offload onto those with less. Furthermore, if used only for financing strategic plans of the Lisbon Agenda, Eurobonds would repay themselves (either entirely or in large part) and not burden future generations.

Issuing Eurobonds offers another way of creating an asset class attractive to large global investors and the arguments in favour of such issue are well known. The European Union’s increased need to attract a large volume of financial resources from global markets in support of strategic investments is essential to securing the region’s elite status in fields of knowledge, technology, environment, culture, social cohesion and civil progress. Moving forward, the world’s financial markets will likely show extraordinary growing supply of savings in emerging economies. During the recent crisis, intense competition among public debts expanded markedly in advanced economies. Socially cohesive sound economies boasting achievements in technology and the environment will inspire global investors’ confidence and attract increasing resources.

The dollar’s strength has permitted the United States to finance its growth by borrowing from the rest of the world. Europe should do the same. Infrastructure built by public means, when mature, should manage to repay the debt it induced. This is the Golden Rule in public finance. New European sovereign debt dedicated to finance capital investments, as opposed to current spending, will not burden public finances or future generations.

7. Conclusions

Europe can stimulate growth in coming years by investing heavily in energy, the environment, transport and telecommunications, and making use of innovative, long-term financial instruments that do not burden public finances and consequently, future generations.

As more advanced economies compete to attract resources from the rest of the world, it is probable, that the euro will strengthen in relation to the dollar in its stability, reliability and thereby fortify the securities issued by European institutions in world financial markets. Therefore, it is time to reap the benefits of Europe's stability policy and attract capital for investment in projects that achieve sustainable, eco-compatible and socially advanced growth. The countries that promise increasing "surpluses" of savings (China, India, Russia, Brazil, Mexico) will seek investment opportunities, new technology and infrastructure development, and Europe must participate in this process. In decades to come, the relationship between advanced and emerging countries will inevitably be reciprocal. If Europe implements strong, proactive cooperation policies with the emerging economies – both attracting capital and offering technology and expertise for sustainable development – then exchange will permit bilateral gain and will uphold common good.

To achieve these objectives the EU should set a special agenda including a revised regulatory system, a special accounting and fiscal framework for long-term investments in strategic sectors, a new, strengthened role for long-term European institutional investors and development banks, as well as the creation of new long-term instruments for financing infrastructure.

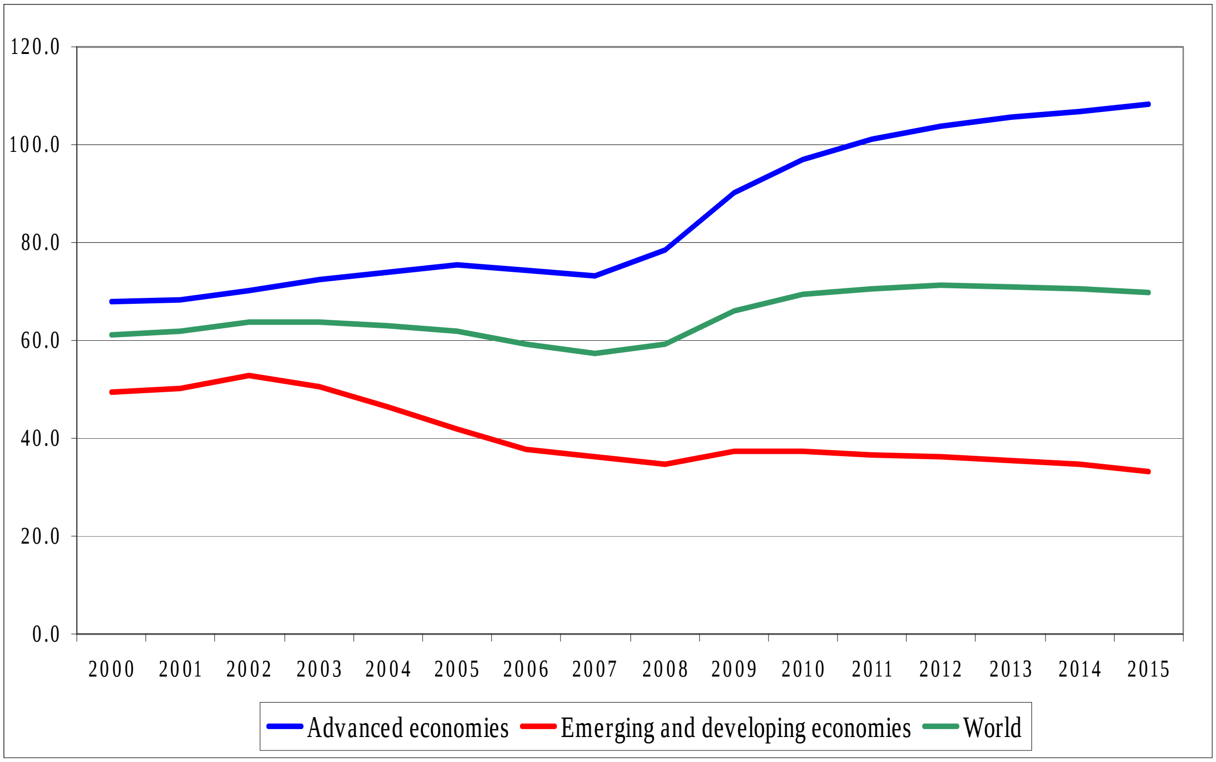
In fact, without substantial changes in prudential, accounting and tax regulations, the objectives set in the EU 2020 Strategy and in the Mario Monti report on the Internal Market strategy will not be reached. An appropriate new European framework for long-term investments and/or investors - as proposed by the de Larosière Report, and, recently, by the 2010 Eurofi Conference - will make a substantial contribution to the promotion of long-term public policies needed to achieve the ambitious goals set forth in the Lisbon Agenda for a sustainable future for our Continent.

Europe is moving quickly after the crisis. The recent decisions taken, show a very high degree of devolution of political powers from the member States to the EU. This means that we are experiencing a change of paradigm, and not just "another crisis". The proposals of the LTIs Club should become part of the new European Agenda.

A new European architecture is taking form. An architecture which is a positive consequence of the crisis. The new system of economic governance which is about to be created is based on three pillars: a new role for the EIB, the new Anti-crisis Fund, the new Growth and Stability Pact, which means a common European policy of fiscal responsibility. These three pillars will protect the European markets and currency from external potential tensions and will create a strong and stable fiscal environment which will have positive effects on the attractiveness of Euro denominated financial instruments. Around these three pillars are there a strong political, almost ideological, framework of shared values of fiscal responsibility and long term growth. This may be the seed of new European governance of political (and industrial) economy. A very strong step head, a major devolution of powers. We believe that the LTI philosophy and proposals should be included in the very foundations of this new European system of governance.

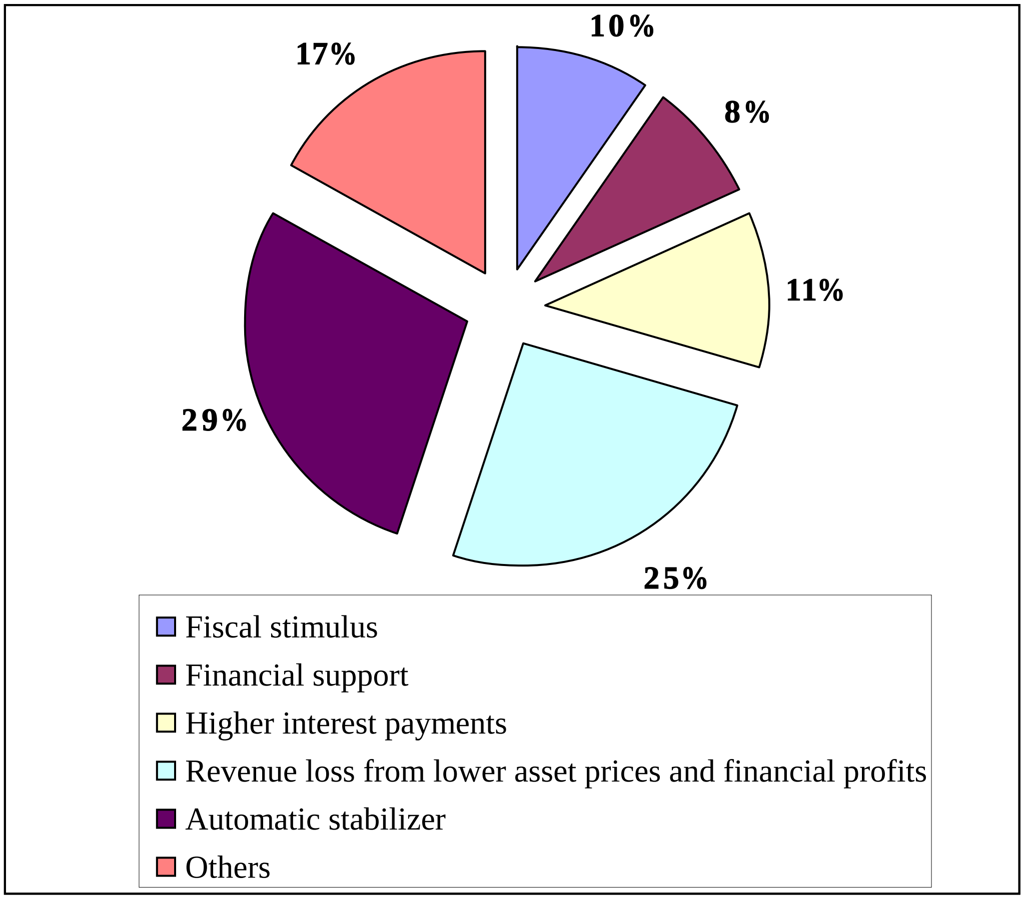
8. *Figures and Tables*

Figure 1 - Public Debt, Advanced and Emerging Economies



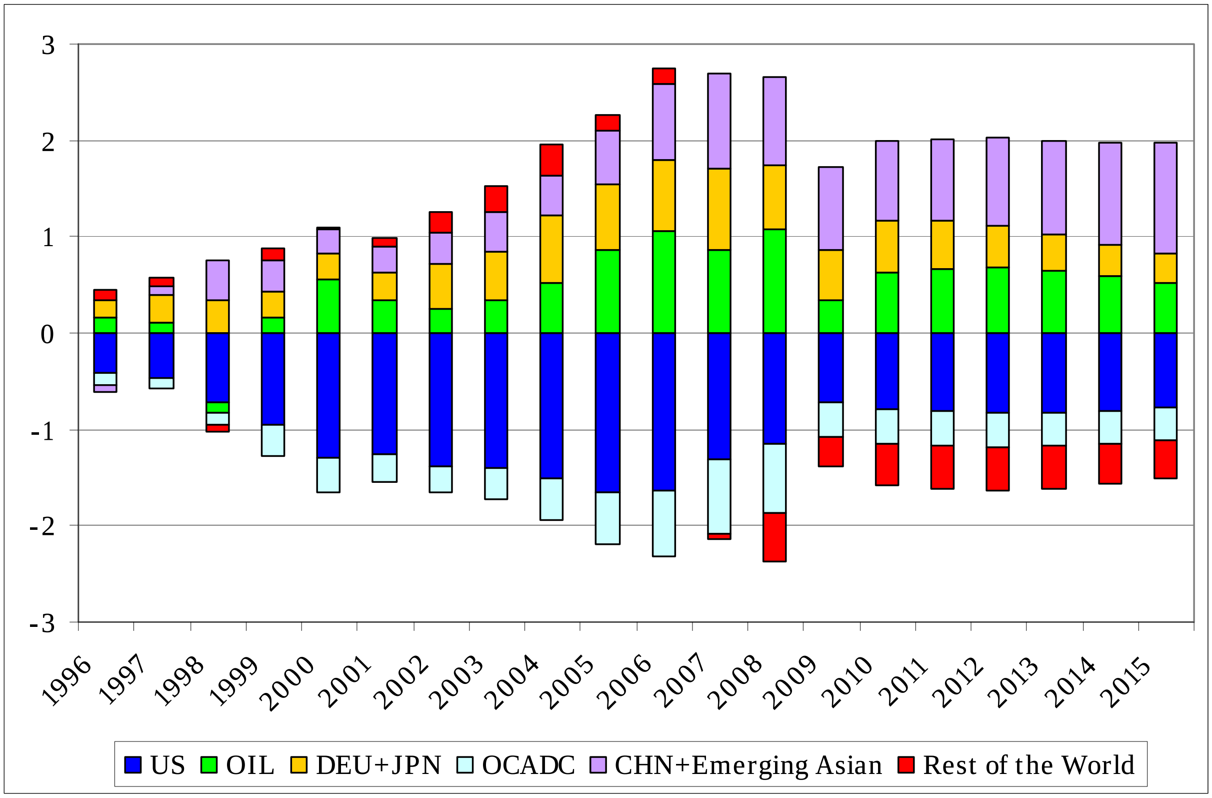
Source: IMF (2010)

Figure 2 - Government Debt Increase, 2007–14



Note: Our calculations on IFM (2010) data. Debt increase: 35.5% of total GDP.

Figure 3 - The evolution of global imbalances



Note: *CHN+Emerging Asian*: China, Hong Kong SAR, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan Province of China, and Thailand; *DEU+JPN*: Germany and Japan; *OCADC*: Bulgaria, Croatia, Czech Republic, Estonia, Greece, Hungary, Ireland, Latvia, Lithuania, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Turkey, and United Kingdom; *OIL*: Oil exporters; *ROW*: rest of the world
Source IFM (2010).

Table 1 - GDP growth projections

			projections	
	2008	2009	2010	2011
World Output	**3.0**	**-0.6**	**4.6**	**4.3**
Advanced Economies	**0.5**	**-3.2**	**2.6**	**2.4**
United States	0.4	-2.4	3.3	2.9
Euro Area	**0.6**	**-4.1**	**1.0**	**1.3**
Germany	*1.2*	*-4.9*	*1.4*	*1.6*
France	*0.1*	*-2.5*	*1.4*	*1.6*
Italy	*-1.3*	*-5.0*	*0.9*	*1.1*
Spain	*0.9*	*-3.6*	*-0.4*	*0.6*
Japan	-1.2	-5.2	2.4	1.8
United Kingdom	0.5	-4.9	1.2	2.1
Canada	0.5	-2.5	3.6	2.8
Other Advanced Economies	1.7	-1.2	4.6	3.7
Newly Industrialized Asian Economies	1.8	-0.9	6.7	4.7
Emerging and Developing Economies	**6.1**	**2.5**	**6.8**	**6.4**
Central and Eastern Europe	3.1	-3.6	3.2	3.4
Commonwealth of Independent States	5.5	-6.6	4.3	4.3
Developing Asia	7.7	6.9	9.2	8.5
China	*9.6*	*9.1*	*10.5*	*9.6*
India	*6.4*	*5.7*	*9.4*	*8.4*
Middle East and North Africa	5.3	2.4	4.5	4.9
Sub-Saharan Africa	5.6	2.2	5.0	5.9
Western Hemisphere	4.2	-1.8	4.8	4.0

Source: IMF (2010)

Table 2 - Savings and Investments (percent of GDP)

	Average 1996-03	2004	2005	2006	2007	2008	2009	*Projections* 2010	2011	2012-15
World										
Savings	21.8	22.1	22.8	24.1	24.3	24.1	21.8	23.0	23.8	25.1
Investment	22.1	22.1	22.5	23.2	23.7	23.8	21.6	22.6	23.3	24.6
Advanced Economies										
Savings	21.0	20.0	20.2	20.9	20.8	19.6	17.1	18.1	18.9	19.7
Investment	21.3	20.7	21.2	21.6	21.6	20.9	17.8	18.4	19.0	20.1
Net lending	***-0.3***	***-0.7***	***-1.0***	***-0.7***	***-0.8***	***-1.3***	***-0.7***	***-0.3***	***-0.1***	***-0.4***
United States										
Savings	17.0	14.5	15.1	16.2	14.3	12.4	10.9	12.4	13.8	15.5
Investment	19.6	19.7	20.3	20.5	19.6	18.0	14.8	15.9	16.5	18.5
Net lending	***-2.6***	***-5.2***	***-5.2***	***-4.3***	***-5.3***	***-5.6***	***-3.9***	***-3.5***	***-2.7***	***-3.0***
Euro Area										
Savings	21.3	21.9	21.6	22.6	23.4	22.0	19.0	19.6	19.9	20.1
Investment	20.8	20.4	20.8	21.7	22.3	21.9	18.9	18.8	18.9	19.4
Net lending	***0.5***	***1.5***	***0.8***	***0.9***	***1.1***	***0.1***	***0.1***	***0.8***	***1.0***	***0.7***
Germany										
Savings	20.0	22.9	23.2	25.7	28.8	28.4	23.3	24.9	24.5	23.0
Investment	20.2	17.1	16.9	17.6	18.3	18.5	16.5	17.0	17.0	17.2
Net lending	*-0.2*	*5.8*	*6.3*	*8.1*	*10.5*	*9.9*	*6.8*	*7.9*	*7.5*	*5.8*
France										
Savings	21.0	20.0	19.8	20.6	21.2	20.1	17.1	17.8	18.4	18.8
Investment	18.9	19.5	20.3	21.1	22.2	22.0	19.0	19.6	20.1	20.6
Net lending	*2.1*	*0.5*	*-0.5*	*-0.5*	*-1.0*	*-1.9*	*-1.9*	*-1.8*	*-1.7*	*-1.8*
Italy										
Savings	20.9	19.9	19.0	19.0	19.4	17.7	15.7	16.4	17.1	17.9
Investment	20.2	20.8	20.7	21.6	21.9	21.1	18.9	19.3	19.8	20.4
Net lending	*0.7*	*-0.9*	*-1.7*	*-2.6*	*-2.5*	*-3.4*	*-3.2*	*-2.9*	*-2.7*	*-2.5*
NIA Economies										
Savings	32.2	32.9	31.6	31.9	32.5	32.7	32.2	33.6	33.5	32.9
Investment	28.1	26.7	26.1	26.4	26.1	27.8	23.6	26.5	26.6	26.9
Net Lending	*4.1*	*6.2*	*5.5*	*5.5*	*6.4*	*4.9*	*8.6*	*7.1*	*6.9*	*6.0*
Emerging Economies										
Savings	25.0	29.6	31.1	33.0	33.3	33.8	32.1	32.5	32.9	33.8
Investment	25.0	27.3	26.9	27.9	29.2	30.3	30.1	31.0	31.5	32.0
Net Lending	*0.0*	*2.3*	*4.2*	*5.1*	*4.1*	*3.5*	*2.0*	*1.5*	*1.4*	*1.8*
Developing Asia										
Savings	32.9	38.4	40.2	42.9	43.8	44.2	45.0	44.6	44.7	45.4
Investment	31.5	35.8	36.1	36.9	36.9	38.4	40.9	41.6	41.7	41.5
Net Lending	*1.4*	*2.6*	*4.1*	*6.0*	*6.9*	*5.8*	*4.1*	*3.0*	*3.0*	*3.9*

Note: Data are not directly comparable due to the different regional and country aggregation.
Source: IMF (2010).

Table 3 - Size of long-term investors

Pension Funds	29.5
Insurance Companies	20.0
Sovereign Wealth Funds and Public Savings Banks	3.8
Total	53.3

Note: Values at the end of 2009, trillion dollars. Source: Conseil d'Analyse Économique, Investissements et investisseurs de long terme, 2010.