Groupe Finance
Position Paper

Long-term investment

13 December 2017

It is only by looking long-term that we can shape a future for Europe. There has been some recent progress, but bridging the gap between "where we are aiming at" and "where we currently are" (or using Philippe Herzog, founding president of Confrontations Europe's words: "the long-term spirit" and "the legacy") still requires substantial work.

After 15 years of fight by Confrontations Europe and our network of partners (industrial players from different sectors, private and public financial players from different European countries), it is the European Commission, and not so much the Member States, which started to raise issues of mutual interest on long term investment, of financing of the economy. But we still need a qualitative change.

Following the third edition of CONFRONTATIONS EUROPE'S Conference on Long Term held in Brussels on October 26, 2017, this Policy Brief highlights a series of recommendations to key EU policy-makers.

CONFRONTATIONS EUROPE

1 – The Need To Combine Stability And Development

Financial stability remains unachieved, we don't know where the next crisis will come from (bond crisis? asset prince bubble? …), and geopolitical uncertainties are rising. Development is not granted, because EU's growth potential and cohesion are weak.

There is no economic development of Europe without financial stability, but development contributes to stability, or worse, the absence of development could destroy financial stability. **The imperative of financial stability can't be considered alone, but in conjunction with the request of development.**

Explicitly include stability and development in supervisors' mandates, as in the US or in Japan

The current economic recovery is limited to business cycles and is every time weaker despite accommodating monetary policy and rather neutral fiscal policy. Structural problems (sluggish potential growth, long-term competitiveness, and divergences between member states, between winners and losers) have not disappeared. Economic zones with stagnant demography can't find growth drivers in consumption, but in investment. **The recent economic recovery does not justify to stop the policy to support investment.**

Recommendation 1

Carve an explicit place to investment in the coordination of economic policies

In order to finance an ambitious investment plan, while deleveraging, we absolutely need low interest rates, which should be the case in Europe, given the European Central Bank (ECB)'s recent decision. In addition, ECB cannot achieve it all.

Recommendation 2

Develop a real European policy mix, as there is so far no European budget

Clarify the needs and show to the citizens that pooling common resources will save money at home will help rehabilitate the EU budget and win the battle for own resources. Rethinking the EU budget cannot come before elaborating together common goods (agriculture, cohesion…). Ensure that the Multiannual Financial Framework isn't approved before the new mandate, for it shouldn't bind the hands of players for several years. Shift structural funds towards financing investment of common interest.

Recommendation 3

Don't re-conduct the Juncker Plan without net resources

I1 – Cooperate On Investments Of European Interest

Given stiff global competition and current trends to intra-EU fragmentation, there is a crucial need for **a real European industrial strategy** aimed at strengthening EU's competitiveness and cohesion sustainably.

We should stop measuring economic progress through short-term activity flows. If we agree with Amartya Sen that progress stems from people's capacities to live the life they choose, we should also monitor progress through measures of access to different kinds of assets: financial assets, natural capital, intangible assets, infrastructures, human and social capital.

Focus on projects with European added value in human capital, collective security, spatial, digital, energy, and other sources of sustainable development:

Recommendation 4

Develop a common strategy on human capital to bridge the biggest gap in investment needs

The EU is falling behind China, Japan, Korea on innovation and skills, and the quality of our stock of capital at the age of technological transformation is below standards, we need to co-finance massive reskilling and upskilling everywhere in Europe, not just where unemployment rate is the highest. Integrating refugees and migrants can only happen through work. We lack engineers, but also carpenters, electricians…We need to be global leaders in innovation, and to carry everyone along. If we are not the most attractive, we will, as a continent, be falling behind.

Recommendation 5

Reprioritize investments in infrastructures

This encompasses energy efficiency/renewables/other energy sources, transportation, and food system. Today, infrastructure investment is 20% below pre-crisis level.

Recommendation 6

Spur industrial innovation in digital, energy, and other sources of sustainable development

This requires distinguishing among the different sectors (automotive, aeronautics, …). Give innovation a greater role, including in cohesion policy, to ensure that everyone is driven up and every region has a minimum of innovation.

Recommendation 7

Create the right framework for all stakeholders to cooperate on the elaboration of investments of European interest

Once these areas identified, we need more guidance on what objectives, what sectors, as well as more complementarities and division of labor within the EU. Less instrument obsession and more content built into policies. So far, nobody is able to think a long-term strategy of investment targeting. EU2020 is not sufficient to target Juncker funds. To develop a capacity of strategic planning, the European Commission should work in a network of pan-European and national bodies. Actually, we need to create the right framework for all stakeholders to cooperate on the elaboration of such strategies: putting public, private, civil society, academic actors together, to define a region's specialization[1] is a cultural revolution which hasn't been achieved everywhere, but remains a key success factor.

[1] Smart specialization strategies

III – Take The Necessary Means To Develop Pipelines Of Projects

Projects from SMEs, sectoral players, localities and regions require to develop the role of development banks in many countries and their cooperation. Technical assistance, including to design and structure quality projects is key. Small projects need to be bundled in investment platforms and require much more efforts to set up and accompany all along project cycles. This is also true for the development of pipelines of social infrastructure investments (for schools, hospitals, affordable housing).

Regionalize the hub of technical assistance (EIAH) would help develop a greater pipeline of quality investment projects. In addition, including all national development banks as shareholders in EFSI's capital and networking them as the European Central Bank system would help pool equity capital.

Recommendation 8

Build the technical skills of local authorities, i.e. 55% of public investment in Europe

This requires differentiating between awareness raising for smaller cities and technical assistance for bigger cities and regions: build capacity to develop investment projects and pipelines, namely infrastructures and very complex investment package.

EFSI II has taken small projects platforms into account, but still neglects the huge technical assistance required to set up and accompany such projects, whereas bringing small projects to be financed by big money would substantially bolster the productivity of territories.

Recommendation 9

Explore local monetary funds (which are approved by the public) to develop an autonomy of regions in Europe (refer to the Swiss example where they play a considerable role)

Recommendation 10

Explore measures to develop local and regional capital markets

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Recommendation 10

Design incentives for cross-border investments:

- Financially incentivize private investors to finance cross-border projects;
- Incentivize national development banks' cooperation to tap their expertise in designing cross-border projects;
- Developing cross-border infrastructures of common interest requires strategic planning

1V – Start To Build A Financial Union

Starting to build a financial union requires finalizing the banking union, and building the capital market union, which are the priorities.

The financial crisis in 2008 and the euro crisis have led to the decision to create a banking union with a centralized supervision and a capital market union to reduce the reliance of SMEs on bank loans. A lot has been achieved over the last ten years, more remains to be done. The recent example of Italian banks show that the current supervisory framework hasn't yet enabled to severe everywhere the vicious link between banks and sovereign bonds. Finalizing the banking union is all the more relevant.

Recommendation 11

Consolidate the Banking Union to articulate risk reduction and risk sharing

Strengthening the flow of private capital to growing businesses, infrastructures, energy transition and other sources of sustainable growth is precisely what the Capital Market Union seeks to do. A lot remains to be done to get stronger and integrated cross-border capital markets. Insurance companies and asset managers are replacing banks in cross-border flows, but capital markets remain highly fragmented and still represent only 40%.

Recommendation 12

Advance the Capital Market Union in a context of constrained public finances and of the departure of the main EU financial center requires

- to mobilize equity for rapidly growing SMEs and innovative businesses
- but also to think strategically what financial infrastructure and industry do we want in Europe at a time of digital transformation.

To match long term liabilities with equity capital, create proper incentives in favor of equity investment, not so much in keeping sovereign bonds **and proper framework** for EU venture capital funds, and channel it to small innovative businesses, especially at early stages to prevent them from going to the US or China.

Abundant long-term and stable savings are not automatically mobilized for long-term investment, because of risk aversion, people's preference for liquidity, final instability of capital flows, underestimation of pensions and dependence needs. Hence the importance of the role of intermediation of financial managers (investment banks, insurance, pension funds, asset managers). To prevent financial crisis, prudential regulation (Basel III/CRD IV for banks, Solvency II for insurance) have focused on the risk of liquidity, with a reference to instantaneous market value with a volatility preventing investment. As regards banks, Europe applies as such international rules (Basel III/CRD IV) tailored to US specificities, which rely for 85% on capital markets. As regards insurance companies, some minor adjustments have been made (prudential calibration for debt and equity investments in infrastructure corporates), but don't encompass all infrastructures.

RECOMMENDATION 13

Ensure international rules are fit for the European market, which still relies on banks for 60%, and tailor the latest standards to our specific environment, just like the US does not to curtail US growth.

RECOMMENDATION 14

Better understand the business model of long term investors. This would help focus regulation on the real risks for insurance companies, the risk of (inadequate) Assets and Liabilities Management, rather than the risk of liquidity.

RECOMMENDATION 15

Develop a European strategy on accounting focusing on long term

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RECOMMENDATION 16

Design an optional regulation for Long Term Investment

Contrary to the US, China, Japan, India, and Brazil, only Europe has adopted the international accounting standards (IAS/IFRS), mostly delegating to the IASB its legislative and regulatory process. Ensure that international accounting rules (IASB standards) don't jeopardize financial stability, nor Europe's economic development, and clarify and extend the "public good" criteria in the context of European governance.

Create "long-term investment compartments" within financial institutions balances (10% to 100% depending on the organizations, for most manage short- and long-term (mixed) assets.

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