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Setting the right incentives for private investments

The world as we know it as well as our economies are changing rapidly. To deal with this change, the European Union has given itself an ambitious agenda and identified two major challenges to prepare for: the twin transitions towards a more digitised economy and towards are less carbon-intensive economy. Particularly the latter one will require massive amounts of investments as it implies a fundamental remodelling of our energy infrastructure from energy generation to energy transmission.

Unfortunately, those investments are not easy to finance. Even before the Covid-19 pandemic struck, we had a consistent and substantial investment gap in the European Union, which the European Union attempted to address with the European Fund for Strategic Investment (EFSI) and later the InvestEU programme.

Even the European Commission has concluded in its "Sustainable Europe Investment Plan" communication that reaching the "old" 2030 climate target of a 40% reduction in greenhouse gases would require an additional 260bn EUR in investments. That was arguably before the European Union decided to substantially increase its 2030 level of ambition and before the impact of the Covid-19 crisis . The pandemic has hit public finances hard and has directed both, public funds and attention away from climate issues and towards immediate crisis relief. The economic fallout of the pandemic will therefore have only increased the investment gap. Part of that delta might be compensated for by the EU's Recovery and Resilience Facility that comes with specific spending targets for digital and climate expenditure.

Nonetheless, in light of a higher level of ambition and additional pressure on public finances, the investment gap has probably increased rather than narrowed. That leaves one major conclusion: **If we want to plug the investment gap, we cannot rely on public money alone**. Even in times of an exceptionally favourable interest rate environment, public finances are stretched. The debt-to-GDP ratio in the Eurozone will likely surpass 100% this year and getting back towards somewhat sustainable debt levels, will leave little fiscal space for grand expenditure programmes.

Ruling out the public sector as a big driver of overall investment, leaves private investment as the key contributor. Private companies will not finance the EU's policy priorities out of the kindness of their heart though, but because they expect a reasonable return. The underlying pre-condition for that is a favourable and predictable regulatory regime, which we have a hand in influencing.

This year, we do have a few chances to get the incentives right: We have three big files that will allow us to set the tracks into the right direction. Firstly, we have the implementation of the Basel III finalisation package, which will determine in a major way how and under what conditions European companies will be able to finance themselves through banks. At a time, when we want European companies to make productive investments, we should be very careful to calibrate the new Basel framework in a way that is conducive to that goal.

Secondly, we have the review of MiFID II, which sets the ground rules of how financial markets in Europe work and how European companies can tap into those markets. We should work on this recast with a view to strengthening EU financial markets, cutting red tape and facilitating market access for both companies and investors. A smart review of MiFID II will go a long way in bolstering up companies' equity base and will allow them to invest in profitable business ventures.

Thirdly, we have the review of Solvency II, which governs how insurance companies can operate across the single market. Insurers are the perfect long-term investors. They have a long-term time horizon and predictable cash-flow needs, yet they currently invest too little in long-term projects, which is due to regulatory reasons. With the Solvency II review, we have a shot at fixing that issue.

If we want to bridge the investment gap, we need to get the legislative framework right to incentivise private investments.