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CDP THINK TANK

Investment at a Time of High Public Debt

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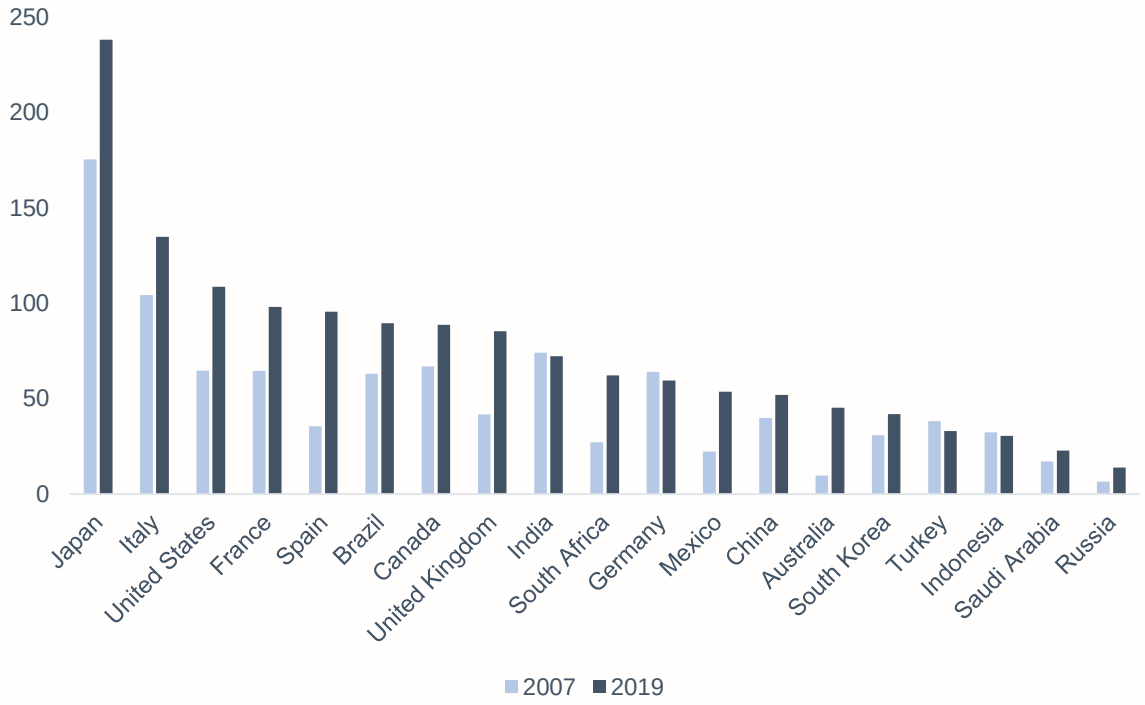
Investing in tomorrow

Countries entered the new crisis in a worse shape than the previous one…

General Government debts (2007 vs 2019, % GDP)

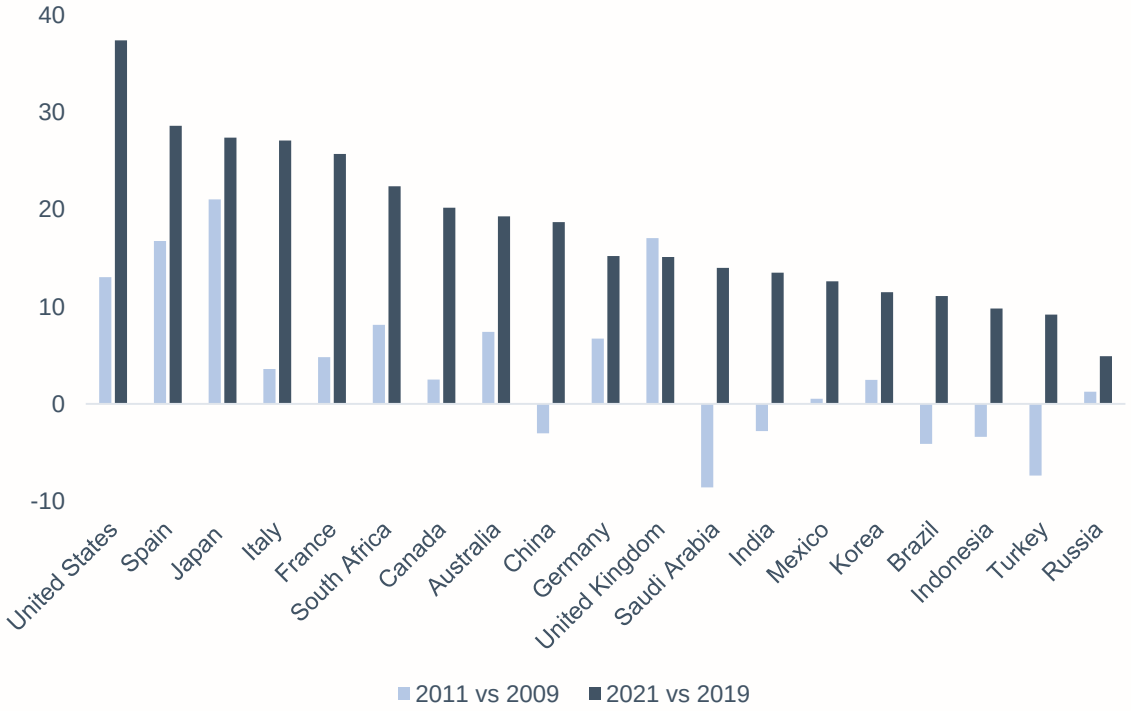


- **Almost all public debts increased** after the previous crisis
- **In the United States nearly doubled**, while in Spain it nearly tripled
- **Only Germany** among developed countries **has reduced** its public debt

Source: CDP Think Tank on IMF data.

…a new increase of debt levels is expected at national level…

2009-2011 debt-to-GDP ratio increase, and expected increase between 2019 and 2021 (% GDP)

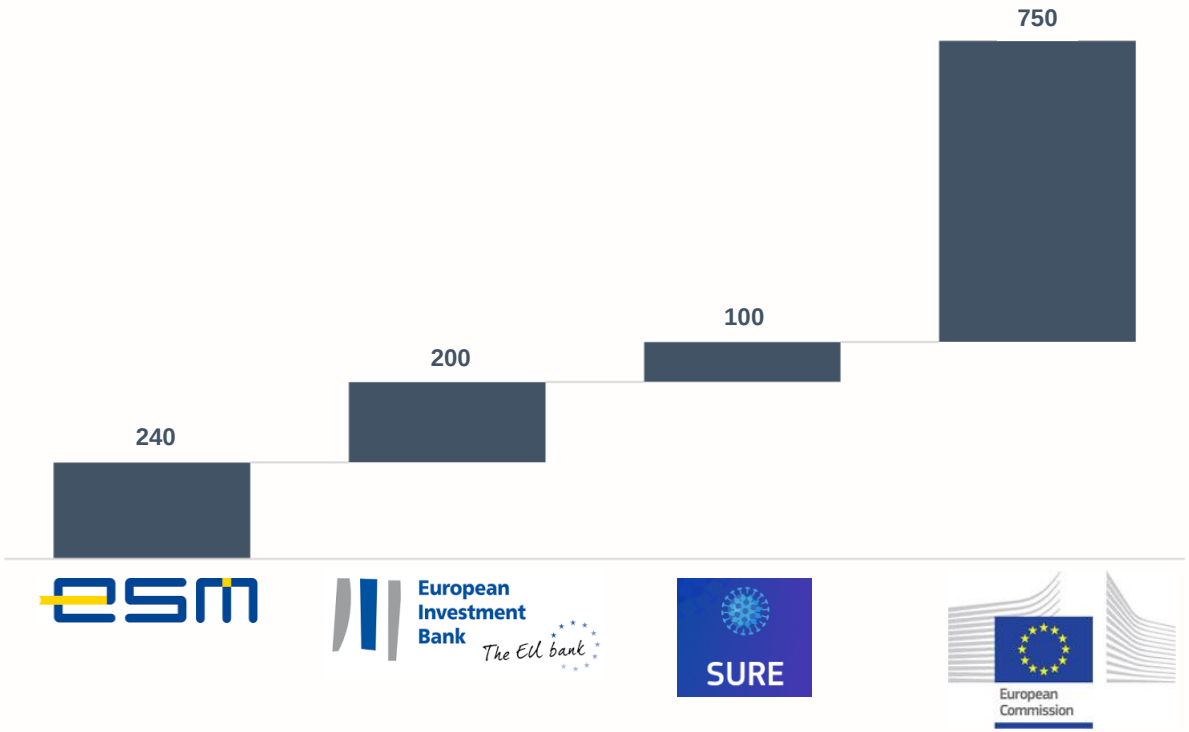


- G20 public **debts** are **expected to rise**
- This is explained by the **contraction of GDP** and the **measures taken to react**
- **US public debt** is expected to grow by almost **40 percentage points**

Source: CDP Think Tank on IMF data.
Note: Data are as of June 12, 2020.

…and even supranational solutions involve debt rises

Fiscal measures adopted by the European institutions (€ bn)

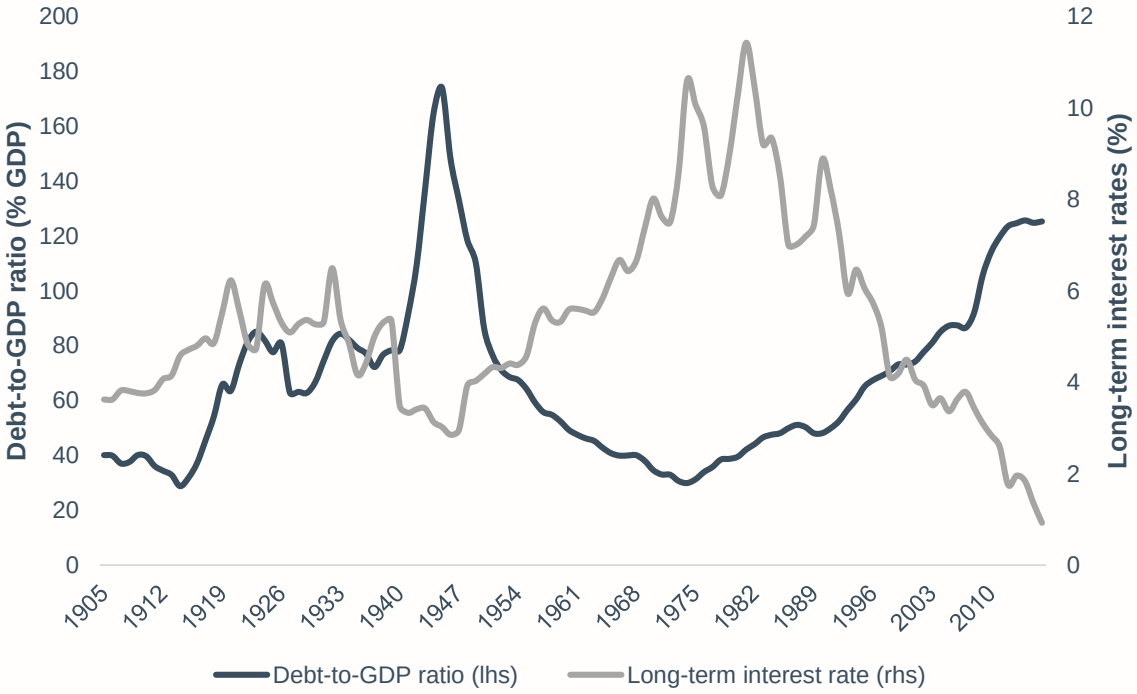


- **Public debt** will also **increase at the supranational level**
- **Debt emission** will be equal to **1100 billion** in Europe
- The focus will be on **investments**

Source: CDP Think Tank on ESM, EIB and European Commission data.

According to some, so high public debts are not a problem…

Debt-to-GDP ratio and long-term interest rates of Japan, US and Germany (average, 1905-2016)



- **Interest rates** in advanced economies **have never been as low as today**
- Hence, **reducing public debt could not be a priority** for countries
- Indeed, such **low interest rates reduce the pressure on public debts**

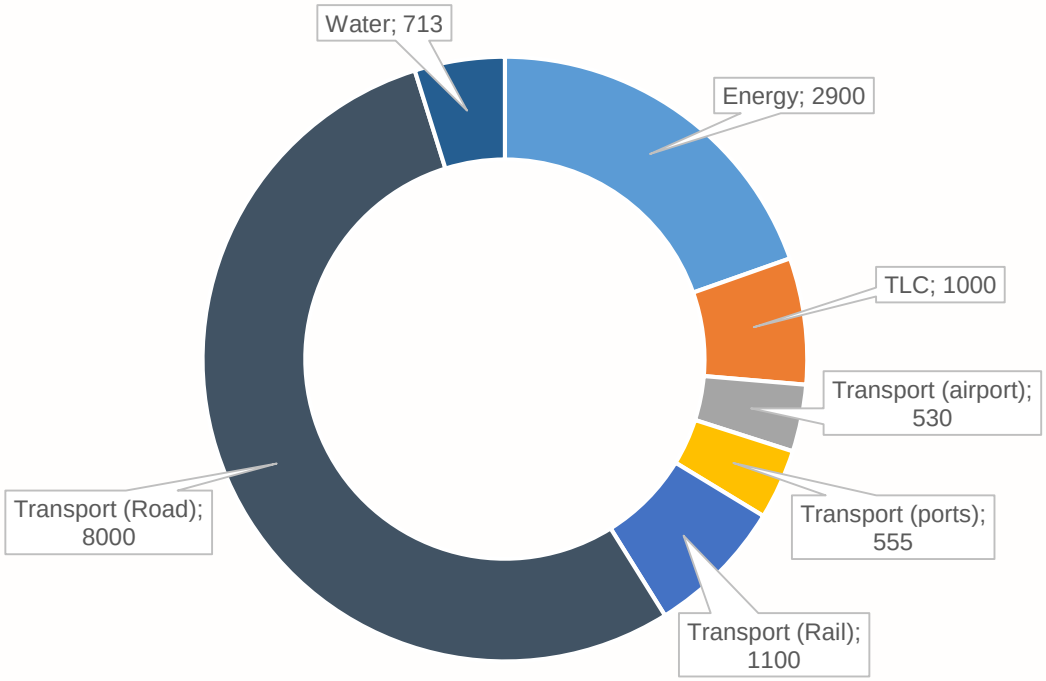
Source: CDP Think Tank on Jordà-Schularick-Taylor macrohistory database.

…but a fiscal buffer to cope with new risks is required

1. **Climate change**
2. New wave of **pandemic**
3. Unequal income distribution and **social tensions**
4. New **financial crisis**

So what? We must find a way to cover the investment gaps…

Global estimated infrastructure investment gaps by sector ($ bn, 2016-2040)

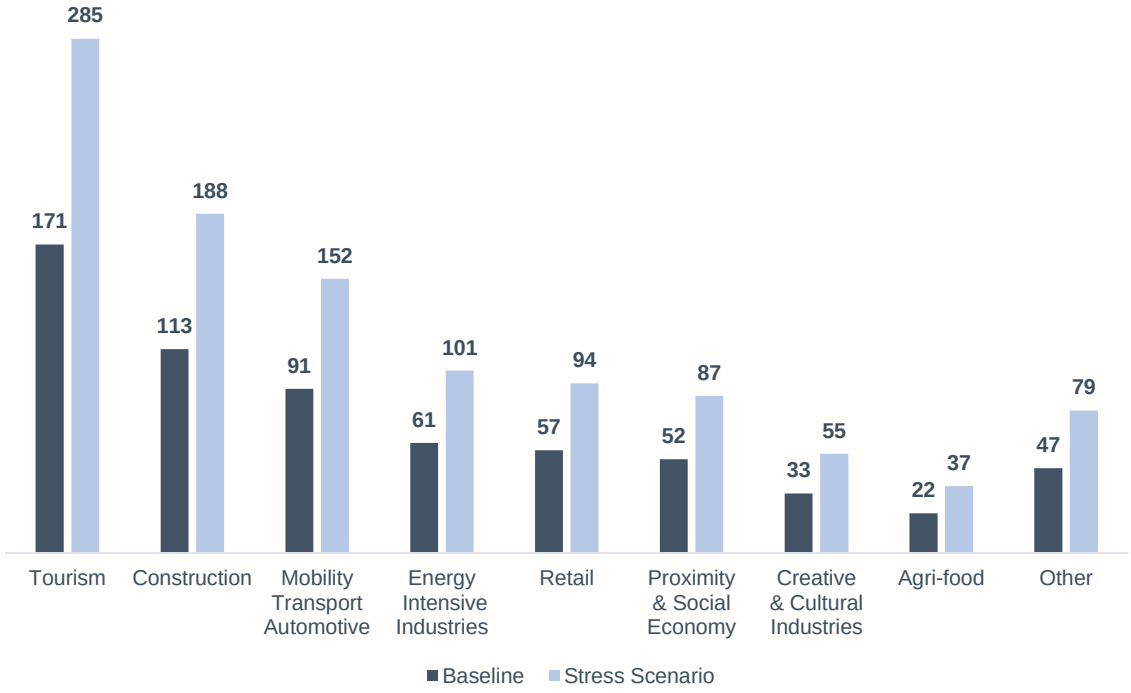


- Before the crisis, **huge investment gaps already existed globally**
- The **gap** estimated for the period 2016-2040 amounted to **almost 15 trillion $**
- New investment needs arising in this crisis will add on these investment gaps

Source: CDP Think Tank on Global Infrastructure Hub data.

…and growing equity needs

Equity losses in the European Union by sector due to the pandemic crisis (€ bn)

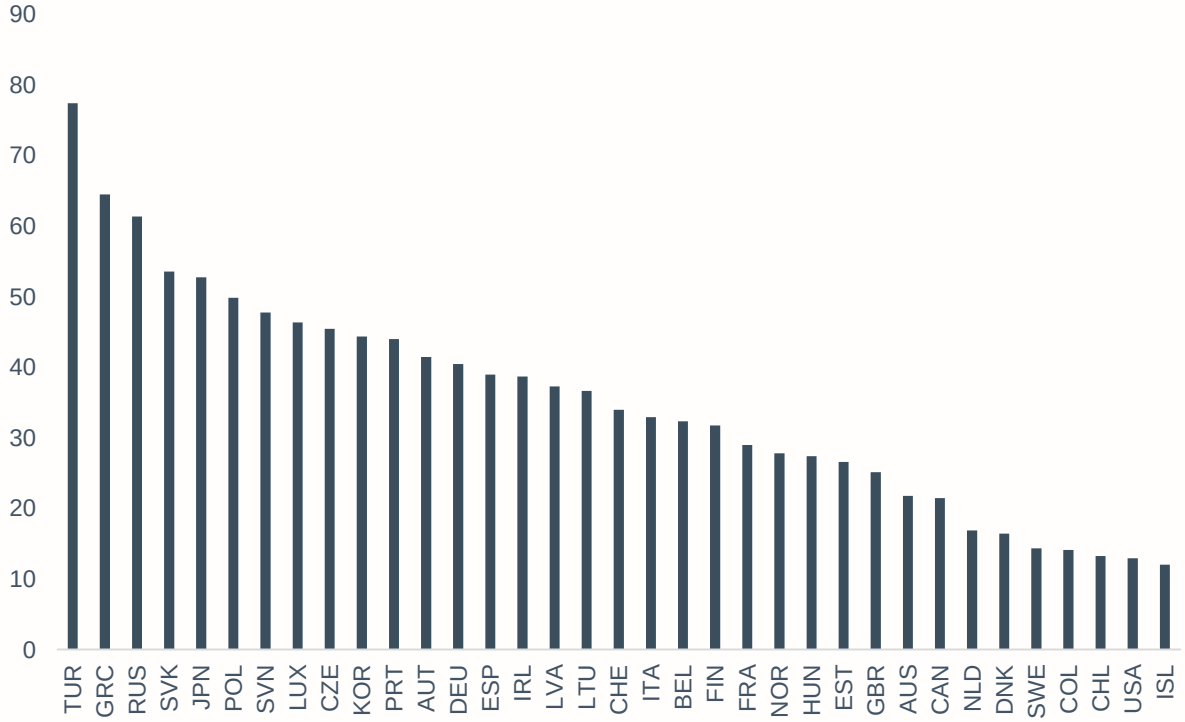


- The **Covid-19 crisis** had a major **impact on** the **equity position**
- Total losses to be incurred by firms could exceed **€720bn in Europe**
- This could reach **€1.2trn** in the stress scenario

Source: CDP Think Tank on European Commission data (as of may 2020).
Note: Other includes Digital, Aerospace & Defence, Textile, Renewable Energy, Electronics.

Private sector has resources: households hold liquidity…

Currency and deposits of households (2018, % of total financial assets)

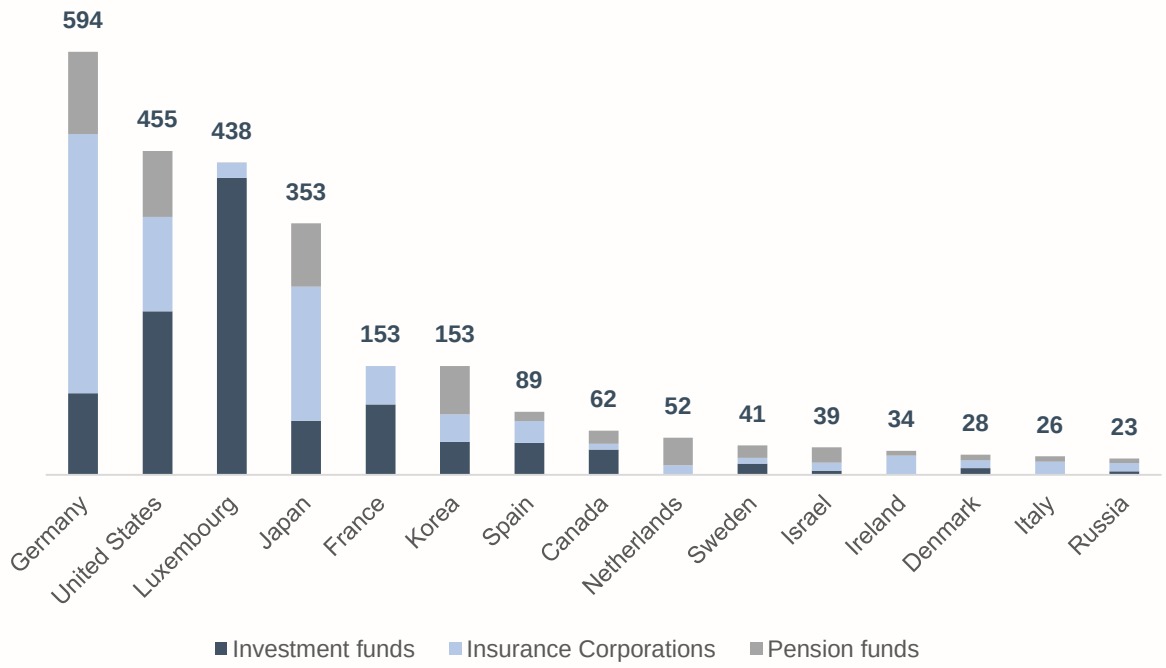


Source: CDP Think Tank on OECD data.

- **We need to look for different sources** in order to finance investments
- **Currency and deposits** compose a great percentage of households' wealth
- We should find a way to channel this amount of liquidity to real economy

… as well as institutional investors

Currency and deposits held by institutional investors (Q2 2018, $ bn, top 15 OECD)

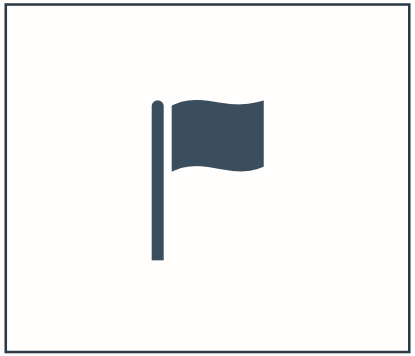


- The **liquidity held by institutional investors** in OECD countries is nearly **2,7 trillion dollars**
- **A small part of this liquidity could** significantly **stimulate private investment**
- Furthermore, the "patient" approach of institutional investors allows for long-term initiatives

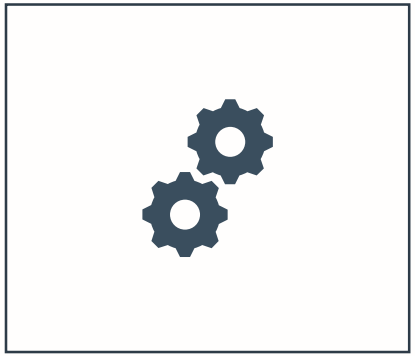
Source: CDP Think Tank on OECD data.
Note: data referred to Investment funds of Italy, Ireland and the Netherlands are not available.

Key is the role of State. Which role?

The paying State



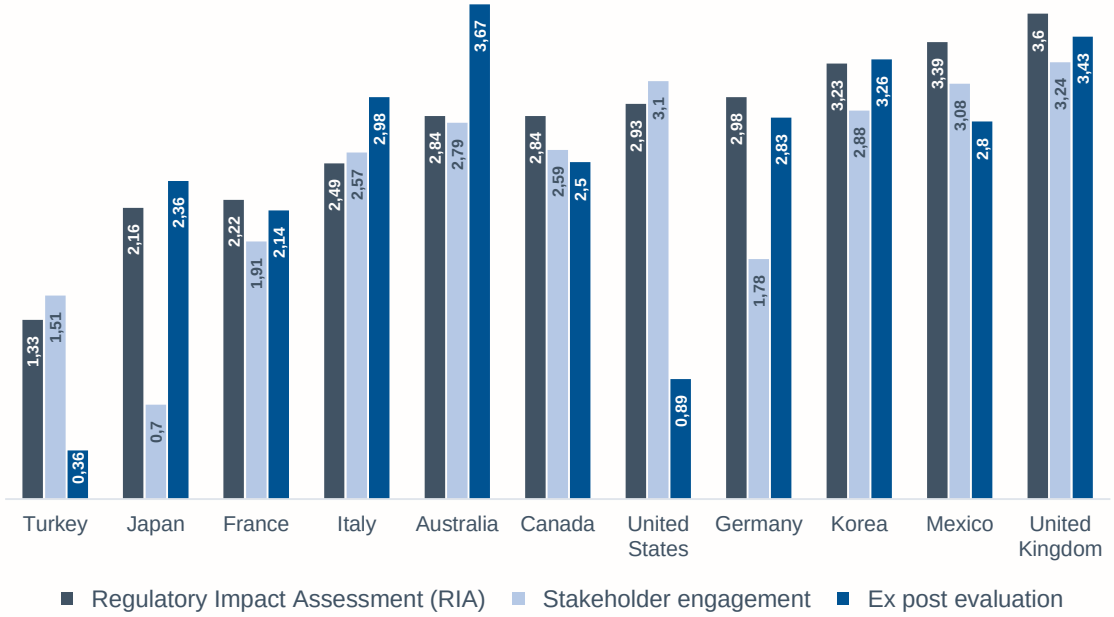
The presiding State



The promoter State

Remove investment barriers…

Composite indicators of Regulatory Policy and Governance (primary laws, 2017)

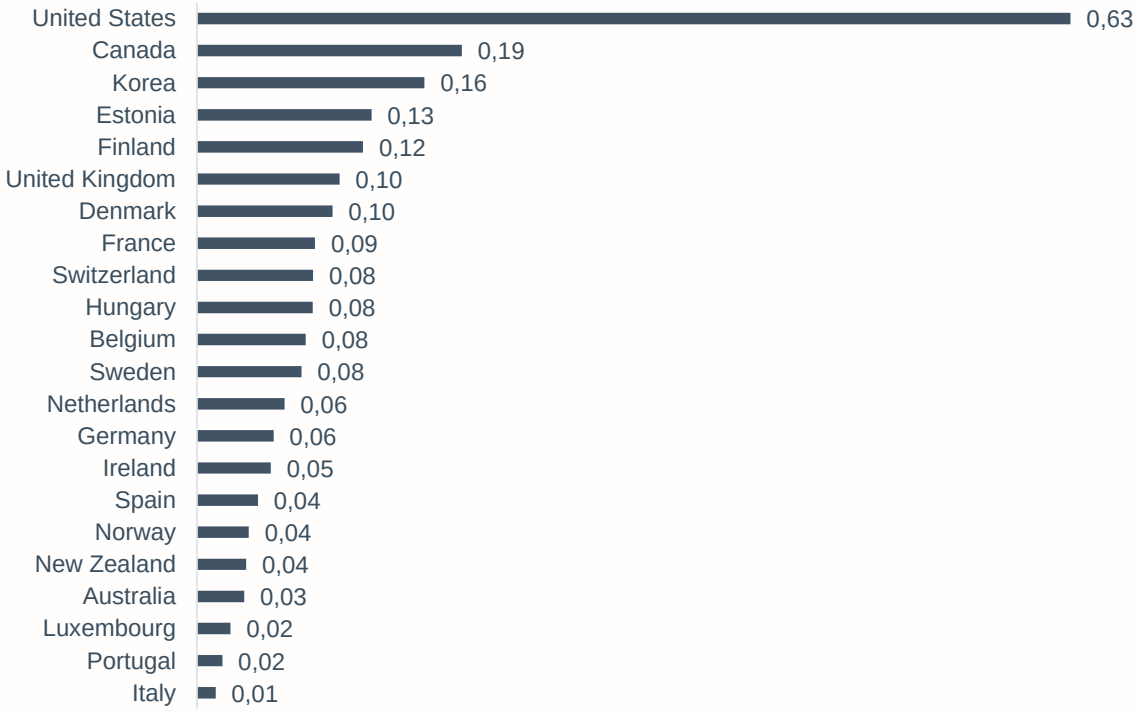


- Possible **investment barriers from regulation**
- Each country could **improve its performance** in regulatory policy
- Areas to identify **ex-ante evaluation** (RIA); **stakeholder engagement**; **ex-post evaluation**

Source: CDP Think Tank on OECD data.
Note: the maximum score for each category is 4. For the United States, indicators about secondary laws are adopted as all primary laws are initiated by Congress, not by the executive.

…and develop appropriate financial instruments as: venture capital…

Venture capital investments (2019, % GDP)

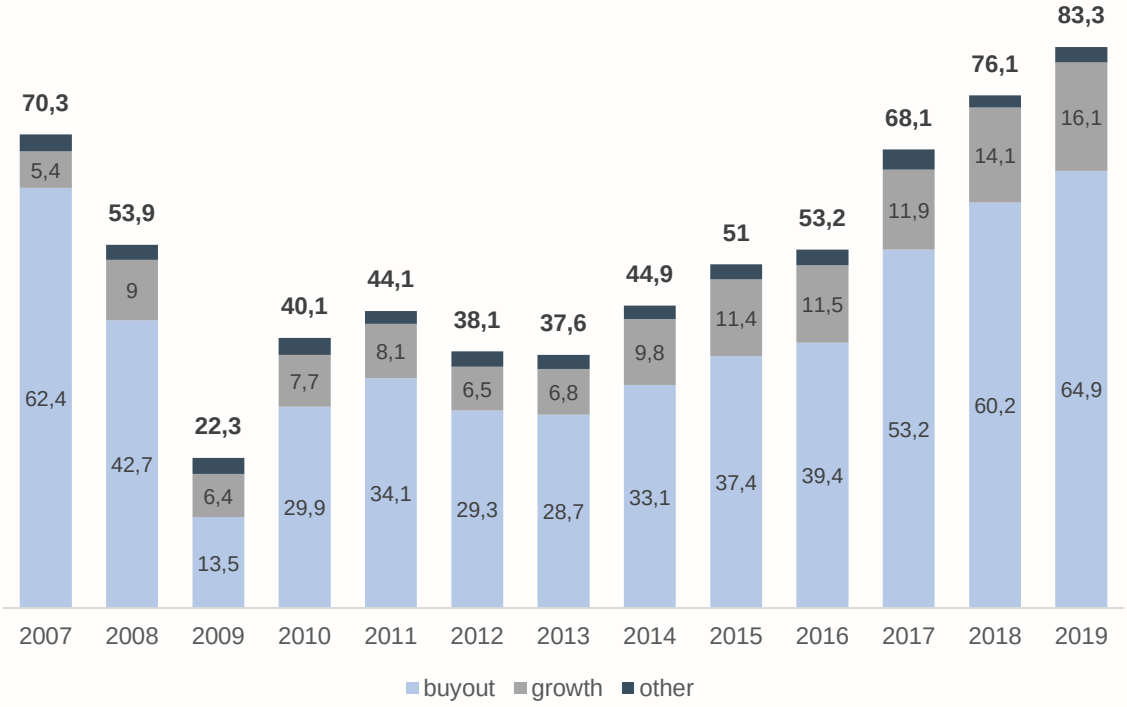


- **Venture capital could be a way** to boost investment
- Venture **capital investments are not well developed**
- Except U.S., **venture capital investments are well below 0,2% of GDP** in OECD countries

Source: CDP Think Tank on OECD data.

…private equity…

Private equity investments in Europe (€ bn)

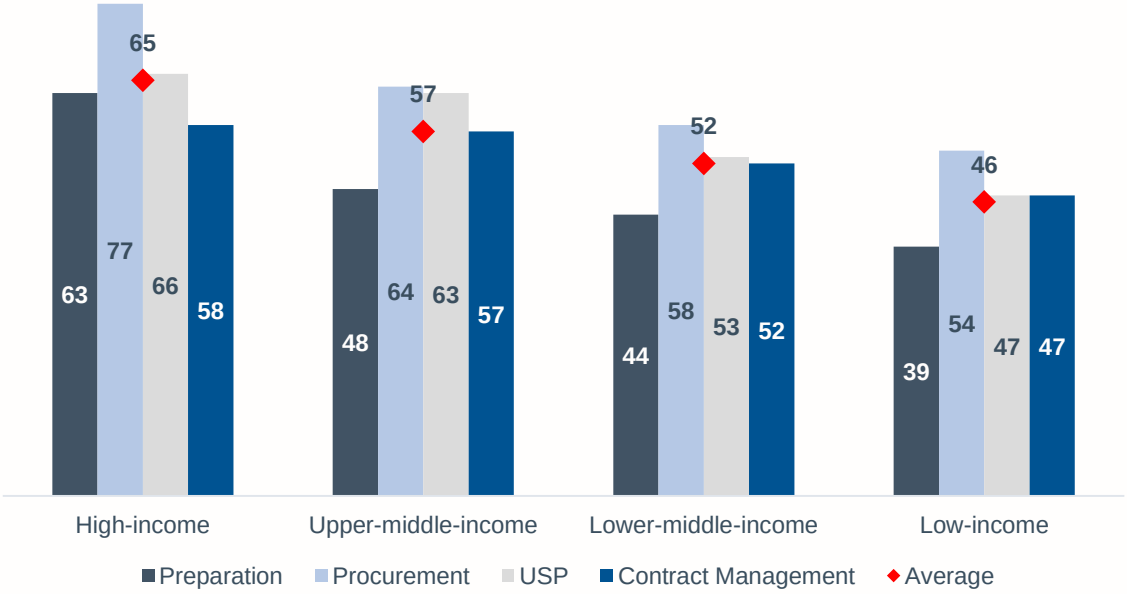


- After 2013, **private equity** has been **continuously growing** in Europe
- Private equity investments in Europe **amounted to 83 billion** euros **in 2019** (94 including Venture Capital)
- However, we can do better

Source: CDP Think Tank on Invest Europe data.

…public-private partnerships…

Procuring Infrastructure PPPs 2018 average scores by country income group (score 1–100)

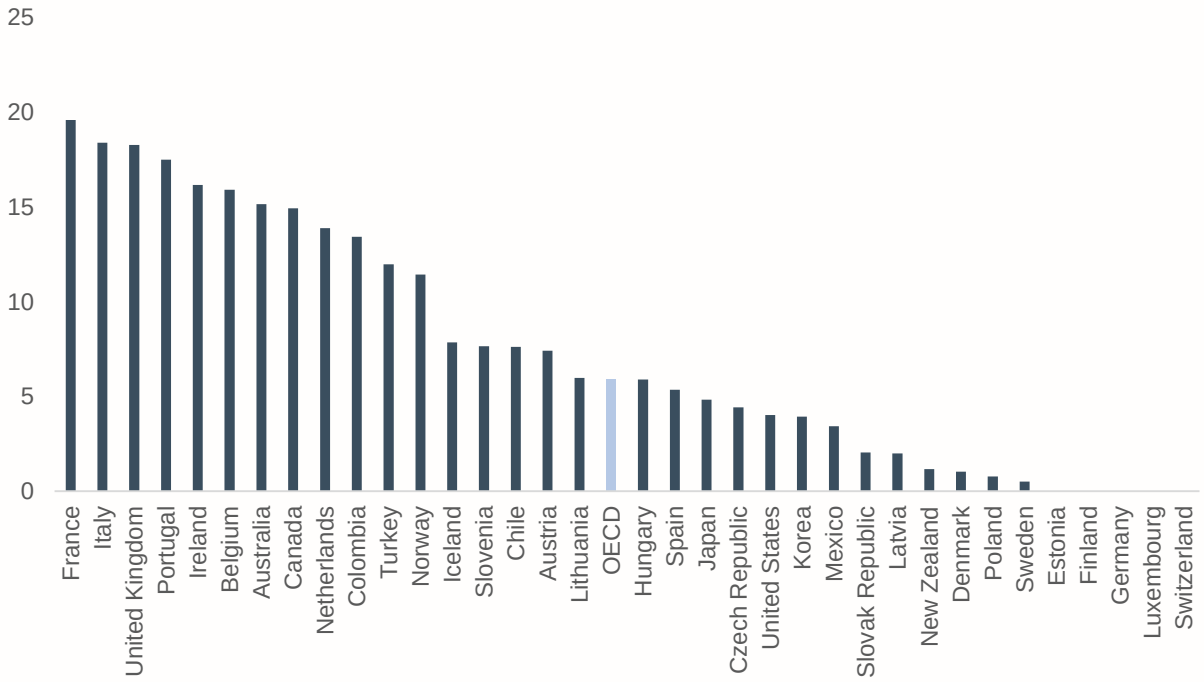


- It is important to evaluate the performance of the public sector in public-private partnerships
- According to the World Bank, the **higher the income level** of the countries, the **higher the performance**
- **Preparation** and **contract management** leave most room for improvement

Source: CDP Think Tank on Procuring Infrastructure Public-Private Partnerships 2018 data, World Bank.
Note: USP = unsolicited proposal.

…and tax incentives to support R&D spending

R&D tax incentives (2017, % of business enterprise expenditure on R&D)



- Among **OECD countries**, **only 6% of spending on R&D** by business enterprises **is covered by tax incentives**
- There is a lot of heterogeneity
- Long-term effects on countries' GDP could lead to a **structural increase in tax revenues**

Source: CDP Think Tank on OECD data.
Note: U.S. data are referred to 2016.

To sum up:

1. **Public debt should be a concern** and national **governments will not have much resources** to finance the economy in the future. Risky if a new shock arises.

2. Time for a **different role of the State**: create the condition to **channel private financial resources toward investment** with high positive externalities.

3. Each country has its specificities, but areas as **PPPs, Private equity and venture capital, appropriate tax incentive** are worth to be explored.