TOMORROW'S CHALLENGES

CASH RICH AND INVESTMENT POOR?

WHY NATIONS NEED AN INFRASTRUCTURE SOVEREIGN BANK

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Greenwich, Connecticut, is one of the wealthiest communities in the US. There, money earned on Wall Street is spent on lavish houses and luxury cars. But mansions are connected to the electricity and telephone lines through a profusion of entangled wires which sway above the heads of bystanders. When there is a storm, fallen branches wreak havoc on the grid. In the region, most houses have their own private generator – just like in many developing countries…

Advanced economies are supposed to have the best infrastructure – at least on paper. The reality is different. The American Society of Civil Engineers estimates that the US needs to invest $3.6 trillion by 2020 to maintain and upgrade its infrastructure. In Europe, the McKinsey Global Institute assesses that governments have under-invested as much as 0.9% of GDP in their infrastructure. Meanwhile, China is spending 8.5% of its GDP on infrastructure projects (compared to 2.6% in the US and 3.6% for the world average). Today, the most innovative infrastructures are found in emerging economies: maglev trains, fancy airports, high-tech harbors, energy efficient buildings, and even education systems.

The economic crisis and budget austerity have trimmed infrastructure investments. The core issue is that such investments over-rely on taxation for funding. They have little capacity to tap the financial markets as an additional source of investment. An infrastructure sovereign bank is the type of institution that would help bridge the gap between short term liquidities and long term infrastructure investments. In reality, most advanced economies are “cash rich” and “investment poor”.

They are cash rich because central banks have injected massive amounts of money into their economies. Quantitative easing has exploded the balance sheets of central banks; since 2006, the balance sheets of the G7 countries’ central banks have gone from $3.4 trillion to more than $11 trillion today. Even the “little” Swiss National Bank has $574 billion in foreign exchange reserves. The cash holdings of large multinational companies are now in excess of $1.7 trillion for US companies and $1.3 trillion for the Europeans.

However, these liquidities have not found their way to the real economy. If they had, we would have inflation, not deflation. The new money is mainly staying in financial markets, or is used for dividends, share buybacks and mergers and acquisitions. Investments are practically at the same level as they were in 2008. In addition, negative interest rates are putting off investors in the short term, because people hope for better remuneration in the future. Many prefer to stay in cash rather than to rely on negative yields: the famous “liquidity trap” of Keynesian economics…

This is highly dangerous. When saving is not profitable, the entire economy is in peril. It can also have important social consequences: how can pension funds guarantee decent retirement services when their capital is not adequately remunerated or when they have to take undue risks while hunting for return?

How would a sovereign institution finance infrastructure? The objective is to place all the financing of a country’s long-term infrastructure under the same umbrella. Doing so, it would require a state guarantee, which is needed to bridge short-term and future risk. It would issue long-term bonds (probably 10 years), with a fixed positive yield. In return for the state guarantee and positive returns, such bonds should be locked and not freely traded on the open market. Before the maturity date, they could only be redeemed by the infrastructure bank at a discounted value. They would be first earmarked for domestic institutions in order to avoid an uncontrolled flood of foreign capital. Finally, the yield on these bonds could be increased by making them tax exempt.

The bank would act as a kind of “Fund of Funds” and would bring together the three main infrastructure domains that would require additional financing: basic infrastructure (roads, rail, and energy), social infrastructure (health, education, and pension), and advanced infrastructure (telecom, broadband internet, etc.). The bank should be linked to a sovereign wealth fund as a source of financing and investment.

In fact, more than 100 sovereign wealth funds already exist throughout the world and manage more than $7.2 trillion. The largest is Norway's which accounts for more than $830bn. The objective of an infrastructure bank is to allow these funds to redirect part of their financial means to the infrastructure of their own country. The bank's board should thus be made up of public authorities representing local and public institutions. However, the operational management should be in the hands of professionals, like Temasek in Singapore.

This type of institution would have several advantages. It would offer a safe and stable opportunity to numerous investors – public or private pension funds, insurance companies, various other enterprises, and even central banks – which today are all looking for positive returns. It would also absorb some excess liquidity from the market and redirect it toward long-term investments. Bonds issued by the bank, backed by governments, would appear as AAA rated debt in the balance sheets of the institutions investing in the scheme.

The main criticism aimed at using short term liquidities to finance long term investment is that it is not "real" money. In other terms, it is "printed" money resulting from central banks' policies, and not "earned" money. But what is real money? Is it the plastic card you buy your clothes with? Is it the line on a computer program which transfers a million dollars to the other side of the world? Or the little piece of paper in your wallet that says "100 dollars" next to the picture of Benjamin Franklin? Real money is simply what allows people to buy something. It is based on trust. A country's competitiveness, its government's credibility, and its central bank's policy guarantee this trust. Nobody has ever refused dollars printed by the US Federal Reserve on the grounds that it is not real money…

Each nation thus needs to consolidate the financing of its infrastructure projects under one umbrella organization, which would solve the problem of solely relying on taxation. Such a sovereign infrastructure bank would pull its weight and use its credibility vis-a-vis financial markets. In many countries, some components already exist. But they are disparate and mainly depend on budget allocations and taxes to pursue their investment strategy.

Infrastructure matters. Whether traditional or advanced, it is the backbone of the competitiveness of a nation. Infrastructure is also a leap of faith into the future and for the next generations. Even in a globalized world, nobody can take infrastructure away from a country. It is one of the few things that a country and its people are ever likely to own and enjoy. So now is the time to reverse "cash rich and investment poor" and put sovereign money to better use.

Stéphane Garelli is a world authority on competitiveness and has pioneered research in this field. He is Professor Emeritus at IMD where he founded the World Competitiveness Centre.

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