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The main strategic role of investment for the developing of economy

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Annotation: Investment, whether it is in the form of private or public investment, has the potential to create jobs, increase productivity, and drive innovation. Moreover, investment can help to spur economic growth in both the short and long term, by increasing consumption, driving exports, and improving infrastructure.
Key words: investment, strategic planning, investors, company, job.

Most advanced economies need to stimulate economic growth to reduce deficits and debt, but growth requires investment, and investment levels have slumped to record lows relative to output. The longer recovery is delayed and capital sits idle, the more skills are lost and the higher the misallocation of resources, making it harder to restore growth. Fiscal policy is generally constrained by the need to build or restore confidence in the sustainability of public debt and, with short-term interest rates close to zero, the effectiveness of monetary policy to stimulate growth is reaching its limits. So the question arises: can policymakers do anything to improve the short-term economic outlook? Some have argued that deregulation will help stimulate business activity. Though this is likely to be correct in the long run, it may not have much effect in a severely demand-deficient environment. This paper argues that a powerful instrument to restore growth is clear and credible policy to encourage investment in welfare-enhancing activities that need public support to be commercially viable. The low-carbon and wider ‘green’ sector is taken as an exemplar field for this. Standard macroeconomics and the economics of market failure tell us that the best time to support investment in such activities is during a protracted economic slowdown. Resource costs are low and the potential to crowd out alternative investment and employment is small. In addition, although public budgets are stretched, there is no shortage either of private capital available for investment, or of investment opportunities with potential for profitable returns. Investment has slumped mainly because households, businesses and banks are nervous about future demand, and have responded by forgoing more risky investment in physical capital. Instead, private agents are squirreling away record levels of private saving into ‘risk-free’ assets such as solvent sovereign bonds. Desired saving has exceeded desired investment to such a degree that global real risk-free interest rates have been pushed to zero and below. These savings are losing value by the day as pension funds and financial institutions pay real interest to (rather than receive interest from) governments; a truly perverse state of affairs given the need for productive investment. These low rates do not reflect a collapse in the underlying returns to capital; they reflect desperately depleted confidence.

The most appropriate area for government to target is investment that the private sector would otherwise under-provide or not provide at all. That is, sectors prone to so-called market failures, missing markets and externalities. It is argued in this policy brief that policies to encourage low-carbon investment offer broad and effective opportunities to restore confidence and to leverage additional, rather than displaced, investment. These policies would generate income for investors and would have credibility in the long term because they address growing externalities and market failures, while tapping into a fast-growing global market for resource efficient activities. Infrastructure – for instance for energy generation, transmission grids and energy efficiency – offers particular opportunities for long-term returns to investors, while also promoting growth. Activities which make use of the rapid development of networked information and communications technologies – the main source of cross-sector productivity gains – offer particular opportunities to stimulate growth-inducing innovation. The private sector is not heavily investing in green innovation and infrastructure because of a lack of confidence in future returns. The lack of confidence in this policy-driven sector is due to uncertainties surrounding current energy and environment policy. It is argued here that governments should incentivise such investment by themselves taking on elements of this policy risk. Because the public sector 'controls' this risk, there is a lot it can do to encourage investment. This should be seen as an opportunity. By backing their own low-carbon policies, governments can stimulate additional net private sector investment, and thereby make a significant contribution to economic growth and employment.

Macroeconomic policy now threatens to prolong the recession unnecessarily. The world is currently experiencing the so-called 'paradox of thrift'. This describes how responding to economic uncertainty by focusing on austerity, cost-cutting and saving to rebuild balance sheets makes perfect sense in terms of good-housekeeping at the level of the individual. It also makes sense for a business, bank or the state. However, when everyone retrenches simultaneously, the collective macroeconomic impact can be disastrous. As spending is cut, businesses postpone investment and shed labour, and banks restrict credit for all but the safest activities. Fear of recession then becomes a self-fulfilling prophecy.9 This 'multiplier' erodes balance sheets and confidence further and prompts another round of retrenchment. The longer recovery is delayed and capital sits idle, the more skills are lost, and the higher the misallocation of resources, which makes it harder to restore growth.

When the private sector is aggressively paying down debt, the best way to avoid a deep recession is for the government to move in the opposite direction and dissave. Indeed, with the public sector acting as 'borrower of last resort' as the private sector retrenched, the ballooning budget deficits of recent years were essential in avoiding a global depression.11 But high public debt levels have raised questions over the willingness or ability of future governments to pay off the debt, with the consequent threat of default, rescheduling, or 'monetisation' of the debt through inflation. The cost of such uncertainty manifests itself in a loss of investor confidence and higher bond rates for vulnerable countries.

Part of the blame for the present situation rests with policy-makers across the world who failed to take sufficient action to reign-in the build-up of private debt during the preceding economic boom. Policy failed to offset excess confidence, indebtedness and asset price valuation during the boom, perhaps inevitably given institutional structures and short-term electoral incentives. Apart from lax levels of bank regulation and supervision, macroeconomic policy was generally too loose, with many governments running current budget deficits during the years when private saving ratios were falling sharply and asset prices were unsustainably inflated. As a result, underlying structural public sector deficits were, in many countries, largely ignored, masked by unsustainably high revenues and low public spending which were assumed to be structural when in fact they were cyclical. At the same time, central banks seemingly followed an asymmetric policy path of cutting interest rates aggressively when recession threatened, but raised them only tentatively when demand and asset values soared. When the bubble finally burst, over-leveraged positions were exposed, asset prices fell and ballooning private debt was transferred to the public sector. This happened directly, as governments bailed out banks, and indirectly as individual and corporate tax revenues collapsed and welfare spending soared.

The public sector will, however, have to commit some resources if it is to make a strong green investment policy credible. This is because in many countries, even where climate policy exists, a major barrier to private investment in the green economy is a lack of confidence in key policy frameworks, such as a long-term carbon price, and the longevity and stringency of emissions and renewable energy targets. But this ‘policy risk’ resides in the hands of policy-makers. Therefore, in order to secure additional (rather than merely displaced) private investment, the public sector should endorse its own policies, and take on risks it controls, whether through direct co-investment with the private sector or through guarantees. This is about instilling confidence, which is a process that will also benefit from progress on international agreements to curb emissions and to establish global policy frameworks. Institutional frameworks also matter greatly. Institutions help bestow credibility on policy and draw private sector expertise. For example, an active and well-capitalised Green Investment Bank can help to reduce policy risk (governments are less likely to change policy if a public long-term investment bank is involved) as well as to take a long-term view using flexible finance. Such a bank can act as a one-stop-shop for banking and sectoral skills in new and important areas and can acquire special convening powers to put together networked sources of finance. The European Investment Bank within the European Union could create additional instruments to cover policy risk and to stand behind infrastructure investments through direct equity or debt finance, insurance policies, first-loss guarantees and other mechanisms. Low-carbon infrastructure investments – in onshore and offshore wind farms, solar plants, biomass, hydropower and associated transmission grids – which can be expected to generate modest but predictable commercial returns over the medium term, are of the sort that many institutional investors are generally keen to have in their portfolios. At present, pension and insurance funds, sovereign wealth funds and banks are putting significant sums into gilts that are earning very little, or even negative, real returns. So, in principle, low-carbon investment offers an attractive prospect.

Investments, being a necessary condition for economic development, are mainly directed to the implementation of priority projects in the sphere of material production and social spheres. Attracting foreign investment plays an important role in the implementation of new technologies, increasing the potential of the country's economy, strengthening its competitive level in the world market, and in introducing advanced management practices.

Attracted foreign direct capital investments, equipment and technology, as well as other assets make a worthy contribution to the development of the country's economy and contribute to its integration into the global economic system. The deeply processed natural resources created by enterprises with the participation of foreign capital affect not only the economic entity itself, but also the development of other areas, creating the basis for macroeconomic growth.

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