Introduction
EUROPEAN INVESTMENT BANK INVESTMENT REPORT
2020/2021

Building a smart and green Europe in the COVID-19 era

Introduction
Investment report 2020/2021: Building a smart and green Europe in the COVID-19 era

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About the Report
The EIB annual report on Investment and Investment Finance is a product of the EIB Economics Department, providing a comprehensive overview of the developments and drivers of investment and its finance in the European Union. It combines an analysis and understanding of key market trends and developments with a more in-depth thematic focus, which this year is devoted to European progress towards a smart and green future in a post-COVID-19 world. The report draws extensively on the results of the annual EIB Investment Survey (EIBIS) and the EIB Municipality Survey. It complements internal EIB analysis with contributions from leading experts in the field.

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The mission of the EIB Economics Department is to provide economic analyses and studies to support the Bank in its operations and in the definition of its positioning, strategy and policy. The Department, a team of 40 economists, is headed by Debora Revoltella, Director of Economics.

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Introduction

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The coronavirus pandemic swept across Europe with a ferocity and speed that caught EU governments by surprise. Facing a vertiginous rise in infections and deaths, governments took drastic action to halt the virus’s spread by severely limiting people’s movement. Those restrictions essentially froze the European economy, and it fell to policymakers to keep its heart beating. Initial attempts to curtail the spread of the coronavirus in early March fell short, and governments found themselves facing a health crisis unlike anything they had ever seen before. As the number of cases and COVID-19-related deaths surged across the European Union, governments took sweeping measures to flatten the curve of new infections and to ease mounting pressure on national health systems. These measures, however, have strangled economic activity. The consequences for employers and employees would have been catastrophic – worse than any modern-day crisis – if policymakers had not stepped in with sweeping measures to limit the economic shock.

The economic policy response was swift and unprecedented. Monetary authorities, national governments and European institutions took concerted action to contain the economic damage and to deliver a quick and comprehensive response. Cash-strapped businesses were injected with funds and central banks ensured that credit flowed freely. Financial regulators pushed for widespread moratoriums on debt repayments and supported massive loan-guarantee programmes. Millions of jobs were saved thanks to programmes to subsidise employment through short-time work schemes. The European Central Bank (ECB) and national monetary authorities also backed up the financial system by providing sufficient liquidity and smoothing the path for public and private debt issuance.

The short-term response to the pandemic proved essential to limiting the fallout, but those short-term measures must be aligned with policies that help the European Union meet its long-term challenges. The partial economic rebound over the summer attested to the success of the policy response in the first half of 2020. While the broad response proved instrumental in stemming the decline in economic activity, it also sucked up substantial public resources. EU government debt increased by 8.4 percentage points to 88% of gross domestic product (GDP) from the first to the second quarter of 2020. The European Commission expects debt to GDP to reach 94% by the end of 2020. A second wave of contagion and lockdowns in the autumn further exacerbated the crisis. The resulting uncertainty raises questions about the sustainability of governments’ blanket support for the private sector. Massive government stimulus, along with weakening private-sector fundamentals and incentives, could potentially derail the European Union’s drive to address its two main challenges – climate change and digitalisation. Aligning short-term support during the crisis with long-term objectives is crucial.

The Investment Report 2020-2021: Building a smart and green Europe in the COVID-19 era focuses on the two major structural challenges for Europe – digitalisation and climate change. It is organised into two parts. The first part outlines trends and developments in investment in the European Union, while the second focuses on the structural challenges of climate change and digitalisation. The experience of the pandemic has stressed just how difficult, but important, it is to address these two issues. The International Energy Agency estimates that greenhouse gas emissions in 2020 will be 8% lower than in 2019 – the largest recorded annual decline. While the decrease is encouraging, it is nowhere near the European Union’s target of a 55% net reduction of carbon emissions by 2030. If anything, the crisis has illustrated the fundamental economic overhaul needed to meet the challenge of climate change. The COVID-19 experience has also confirmed that, going forward, rapid digitalisation is indispensable. The digital capabilities of individuals, firms and governments were key to Europe’s resilience during the pandemic. In the future, growth, innovation and even climate change will increasingly depend on digital interaction. At the same time, digitalisation and climate change adaptation and mitigation will require major structural changes and will challenge social cohesion. Addressing these challenges in a timely manner could maximise the potential benefits of the transition.
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The analysis provided in the report stems from three in-house surveys. The EIB Investment Survey (EIBIS), whose fifth annual survey was conducted in the summer of 2020, adds valuable information about the impact of the coronavirus pandemic. The survey’s climate module was extended, and it provides unique information on the impact of climate change on firms’ decisions. Following the EIB Municipality Survey in 2017, a second survey in 2020 focused on the infrastructure investment decisions of EU cities and municipalities, and asked how climate change was influencing their decisions. The third survey, run online in cooperation with Ipsos, collects companies’ assessments of their efforts to introduce environmental innovations, the motivations for doing so and the obstacles encountered.

The report begins with a detailed analysis of the impact of the pandemic on the economy, overall investment and corporate investment and finance. Chapter 1 sets the scene with an overview of the economic environment, the impact of the pandemic on real economic activity and the financial sector and the economic policy response. It outlines the extraordinary decline in economic activity resulting from government measures to curb the spread of the pandemic and the corresponding swift policy response. It stresses the importance of EU-wide policy initiatives that have the potential to change economic policymaking in the European Union.

Investment in the European Union fell precipitously in the second quarter of 2020. Chapters 2 and 3 home in on corporate investment and investment financing, presenting the main results of the EIBIS 2020. The chapters outline the extraordinary decline in investment triggered by elevated uncertainty and the imposed restrictions on economic activity, even though credit flowed freely and governments and the European Union provided substantial policy support. Despite these supportive measures, investment activity could remain subdued beyond the pandemic because of an erosion in firms’ ability to self-finance their activities. To counteract a longer slowdown, policy support should evolve in stages. Governments, which started by providing liquidity at the onset of the pandemic and then maintained the flow of credit, now need to focus on enhancing the types of financing available for firms by providing more equity products.

The scale of the policy response risks weighing on government investment. The global financial crisis showed that large fiscal stimulus could be followed by a sharp fiscal correction in which government investment falls substantially. The temporary suspension of EU fiscal rules and the massive intervention of the ECB have eased the pressure on governments this time around, allowing them to maintain focus on productive public investment. The benefits should be considerable, since government investment often has a catalytic effect on private investment and positive spillovers to the rest of the EU economy.

Investment in climate change mitigation remains insufficient to achieve the ambitious EU target of achieving carbon neutrality by 2050. Chapter 4 outlines recent investment trends in climate change mitigation and adaptation. While it acknowledges the recent uptick in climate-related investment in the European Union, it stresses the need for further substantial increases if the European Union is to meet its goal of carbon neutrality. To accelerate investment, EU governments and the private sector have important roles to play. Governments will have to scale up investment, but perhaps more importantly, their policy mix should shift towards incentives that will boost investment in climate action. Incentives are crucial because most of the investment needed to make the economy carbon neutral will have to come from the private sector.

The transformation of the economy is a major opportunity for all firms. Chapter 5 focuses on the outstanding climate challenges facing the corporate sector. It probes the degree of awareness of EU firms and their willingness to deal with the effects of climate change. The chapter stresses that firms’ decisions to invest in climate-related measures will affect their competitiveness and determine whether they play an active or passive part in the transformation. Half of the firms in the European Union are investing in climate measures, and they show a stronger propensity to do so than their counterparts in the United States. That said, the pandemic might derail some firms’ investment plans, despite the significant

1 More information about the surveys is available in the Data annex of the report.
spending needed to achieve the European Union’s ambitious targets. These developments underline the importance of the European Green Deal as a catalyst for the green transition. The green deal provides a coherent plan for defining investment in climate change mitigation and adaptation and lays out proper incentives for the public and private sectors. Businesses say they need clarity on the climate. Regulatory uncertainty and taxation are cited as the main impediments for climate-related corporate investment, according to 73% of EU firms.

The financial sector is an important enabler of the green transition. Chapter 6 points out that investor interest is gradually shifting towards companies with clearly defined sustainability goals, but many issues remain. For instance, the uncertainty surrounding the true green content of financial assets reduces investors’ ability to assess their merits. Enhanced information and the development of simple and transparent standards should alleviate major impediments to stronger growth. The important role played by banks in the European Union will require enhanced disclosure about the exposure of bank assets to climate risks.

The digital transformation is taking centre stage, affecting virtually all sectors of the economy. The global innovation landscape is changing rapidly due to the growing importance of digital technologies and the emergence of China. Chapter 7 notes how European firms are lagging when it comes to innovation in the fast-growing digital sectors such as software and computer services, which may create challenges for long-term competitiveness. Furthermore, European firms are not only trailing in digital innovation, but also in digital adoption. In the European Union, 37% of firms remain non-digital, compared with 26% in the United States. Firms say that access to digital infrastructure is more restricted in the European Union compared with the United States. Higher rates of digital innovation and adoption are linked to greater job creation and resilience, but also to higher investment in climate change mitigation and adaptation – investment that is crucial for achieving ambitious European climate targets.

Innovation in green technologies will play a key part in the transition to a carbon-neutral economy. Current technologies are insufficient for meeting the climate goal without significant disruptions to lifestyles in advanced economies or development in emerging economies. Hence, innovation is essential to producing the clean technologies needed for a smooth transition. Chapter 8 builds on an analysis of patent data and the results of the online survey with Ipsos on green innovation to study the important symbiosis between digital and green technologies. The authors stress that technological advances will need to permeate every aspect of our lives, from energy systems to materials and land use, if we are to successfully navigate the transition to carbon neutrality. Digital technologies are expected to make a major contribution to these innovations.

The European Union is currently leading the way in the joint development of green and digital technologies. The transition will require more than creating knowledge. That knowledge will also have to be shared and adopted. The European Union also seems to excel in knowledge diffusion compared to global peers, but this diffusion tends to remain within national borders.

Efforts by cities and municipalities will be instrumental in building a digital and green future. Chapter 9 shows that local government investment in green and digital infrastructure is important for pulling in private investment in climate measures. Gaps in green and digital infrastructure vary across the European Union and exacerbate regional inequality.

The report concludes by studying the impact of digitalisation and the green transition on social cohesion. Chapter 10 looks at how digitalisation and the green transition will create and destroy jobs – while at the same time changing the relative importance of occupations. That upheaval will cause significant shifts in demand for labour, with profound social and economic consequences. This shift is likely to affect regions and countries in the European Union differently, with some parts at greater risk. Dealing with these risks will require strong local governments that can identify future job opportunities, provide adequate support for individuals and devise strategies to transform and revitalise local economies. Providing workers with the necessary skills is essential to managing the disruptions of the twin green and digital transition and to maximising its benefits.
Throughout the report, EU countries are often grouped into three regions with common features. Central and Eastern Europe contains the countries that have joined the European Union since 2004 and that rely substantially on EU cohesion and structural funds. Cyprus, Greece, Italy, Malta, Portugal and Spain form the Southern Europe group. The remaining EU countries are in Western and Northern Europe. While geographical location defines the groups, the countries within each group share many common structural economic characteristics, thereby justifying the regions’ usefulness in economic analysis.
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