



INVESTMENT REPORT
2021/2022



Recovery as a springboard for change

Introduction

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Investment Report 2021/2022: Recovery as a springboard for change.

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About the Report

The EIB annual report on Investment and Investment Finance is a product of the EIB Economics Department. It provides a comprehensive overview of the developments and drivers of investment and its finance in the European Union. The report combines an analysis and understanding of key market trends and developments with a more in-depth thematic focus, which this year is devoted to Europe's progress towards a digital and green future in the post-COVID-19 era. 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.

About the Economics Department of the EIB

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 director of Economics Department, Debora Revoltella, heads a team of 40 economists.

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Introduction

The rapid spread of the coronavirus pandemic in 2020 forced governments to take drastic measures. Lockdowns and social distancing severely impeded the production and acquisition of certain goods and services, triggering a record decline in economic activity. Cash flows at firms dried up, stoking fears of depleting liquidity and capital buffers — and ultimately of mass job losses. The resulting uncertainty affected investment plans substantially, as even cash-rich firms reduced and postponed their projects.

A swift and decisive public response averted an economic catastrophe. Monetary and fiscal authorities stepped up, as did European institutions, to provide a coordinated package of measures that kept credit flowing to businesses, while rescheduling tax and debt repayments and protecting jobs. The response also ensured that governments could finance the major expenditure required by the emergency measures.

The crisis acted as a catalyst for the digitalisation of social and economic activity and did not divert policymakers' attention from climate change. When a crisis hits, governments tend to focus on limiting damage and addressing the immediate causes, and longer-term structural issues temporarily take a backseat. But this time around, policymakers in Europe did not take climate change off their agendas. The [European Green Deal](#) and the adoption of the [European Climate Law](#) in 2021 are prime examples of how the climate has remained a firm priority. Digitalisation also got an unexpected boost. Social distancing pushed firms and individuals toward digital solutions for working and socialising. Whether this new development will provide enough impetus to accelerate the digital transition is not yet clear, and further policy efforts might be necessary. The [Recovery and Resilience Facility](#), which will provide massive EU funds for rebuilding, is a major step in the right direction.

This report takes stock of the economic recovery and analyses its implications for the digital and green transitions. It is organised into three parts. Part I provides an overview of the macroeconomic environment, governments' policy response to the crisis and recent developments in investment in the European Union. Part II examines the longer-term effects of the pandemic on European citizens, businesses and regions, showing how they could be affected in different ways. The effectiveness of governments' support for European firms is also assessed. Part III explores the challenges and opportunities that the ongoing recovery brings for the digital and green transition of European economies.

The analysis in the report relies substantially on surveys and databases developed by the European Investment Bank. The sixth wave of the EIB Investment Survey (EIBIS), conducted in the summer of 2021, provides valuable information about the impact of the coronavirus pandemic and the effect of government support on European firms. The survey's extended climate and digitalisation modules provide information — unique in its kind — on how the digital and green transitions are affecting firms' decisions. A further one-off module provides more details on the impact of COVID-19, climate change and digitalisation on European small and medium businesses. In addition, this year's report continues to make use of the information provided by the 2020 EIB Municipality Survey about infrastructure investment by EU cities and municipalities. The databases on investment in climate change mitigation and patents, developed in house, broaden our understanding of innovation, digitalisation and climate change mitigation. The European Patent Office's PATSTAT database and our specific in-house work on aggregating patent information by technical area enhances our analysis of innovation.

The opening chapter of the 2021/2022 report outlines the macroeconomic environment and governments' response to the economic crisis. It provides an overview of the effects of the pandemic on key economic indicators, such as gross domestic product (GDP) and household income, stressing the differences among countries in the European Union. The chapter examines the fiscal and monetary policy response, differentiating between national and EU policies. It stresses that well-designed fiscal policies are powerful and indispensable during economic crises. Such policies soften the impact of economic shocks on firms and households, spreading their burden more widely across the economy and staggering their effects over time. The analysis underlines the role of the European Union's joint policy response that reinforced the steps taken at the national level.

Special attention is paid to recovery measures and EU-wide fiscal coordination. As the recovery sets in, fiscal policy is shifting its focus from fighting the crisis towards supporting sustainable growth. Unlike the recovery from the global financial crisis, governments are not yet under pressure to consolidate finances, and no one is planning to introduce fiscal tightening in the immediate future. This first chapter also takes a closer look at the national recovery and resilience plans and gives an initial evaluation of their macroeconomic impact on European economies and regions. The results of our analysis argue in favour of European coordination and suggest that government investment should be protected when countries inevitably tighten their budgets. Finally, the chapter looks at how national recovery and resilience programmes are focusing on investments to deal with climate change and to support digitalisation, and it emphasises how these investments can benefit from policy coordination.

The second chapter presents an overview of recent developments in aggregate investment in the European Union. It provides the background for the economic analysis of investment decisions in the rest of the report. The chapter looks at developments in aggregate investment in different asset types, such as buildings or equipment, and institutional sectors of the economy — government, firms and households. Special attention is paid to aggregate investment in three particular areas — infrastructure, innovation and climate change mitigation.

The analysis in Chapter 2 provides comparisons with relevant peer countries. Such comparisons highlight the relative strengths and weaknesses of European investment, showing for example that the European Union's relatively good position in green innovation is counterbalanced by the widening gap with US investment in equipment and intellectual property products. Comparing investment in climate change mitigation shows that China and the United States are increasingly challenging the European Union's leadership in that area.

The second chapter also gives an overview of the latest EIBIS results regarding corporate investment. Corporate investment fell the most during the crisis and its recovery is lagging behind household and government investment. Investment trends are clarified by the information provided by the EIBIS on corporate investment, the near-term outlook and perceived structural impediments to investment. The 2021 survey results confirm that the ongoing recovery is buoying corporate investment. The results also underline that uncertainty and lost sales pose challenges to firms' investment plans in the near term. In the medium term, firms recognise the growing importance of digitalisation for their businesses.

Chapter 3 dives deeper into corporate investment, corporate finance and economic policy support for firms. It reviews EU corporate investment and financing since the beginning of the pandemic and analyses in detail the sources of corporate resilience, the economic implications of the crisis and the likely consequences for firms' decisions. The analysis provides some nuance to the observation that investment was not affected as deeply as initially feared, showing that trends differ among sectors.

As the crisis has continued, it has hit some economic activities harder — and some firms have been seriously weakened. At the beginning of the pandemic, firms relied on the cash buffers they had built up and available credit to finance working capital and cover operating costs. These resources, however, declined as the crisis progressed and profits dwindled. As policies to contain the spread of the pandemic became more selective in late 2020, certain sectors and types of firms showed greater levels of vulnerability. The impact also varied by country because the structure of EU economies changes from one Member State to the next. The negative effects on corporate balance sheets, and therefore investment, have been partially offset by cash holdings and capital positions, along with solid and lasting public support.

The analysis provided in Chapter 3 sheds more light on the relevance and effectiveness of public support for firms. Using the unique data provided by the EIBIS, the chapter shows that public support — in the form of subsidies, delayed payments or credit guarantees — were instrumental in the recovery of firms. Policy support was allocated to the firms most in need, with more support going to the firms that recorded larger sales declines. The support was broad-based and reached the majority of crisis-stricken firms, with little evidence that funds were misallocated. Furthermore, public support enhanced firms' ability to recover from the crisis. Policy intervention has weakened the link between sales and

investment, reducing the risk of weak investment in the medium term. Firms that received public support were more likely to maintain their investment plans and more likely to respond to the pandemic by increasing digitalisation.

Policy support has been impressive, shielding firms from the worst-case scenario, but certain latent pockets of corporate vulnerability may still exist. The effect of the crisis on firms has been uneven, with strong differences among sectors. Size mattered, as smaller firms were more likely to suffer. The share of firms at risk of default has also increased, but this form of vulnerability is once again concentrated in certain sectors. Corporate bankruptcies might still rise, despite the recovery. While the consensus seems to be that policy intervention averted a massive crisis, the extent to which the economy has been damaged, possibly in some systemic way, is still not clear.

The possible uneven and longer-term effects of the COVID-19 crisis extend to economic, social and geographical cohesion. The pandemic's effects were felt differently across the European Union. Chapter 4 demonstrates that the different social and regional vulnerabilities that existed before the crisis are exacerbating the uneven recovery and amplifying existing inequalities. The structural change brought about by the digital and green transitions also risks entrenching regional differences and a lack of social cohesion in the European Union.

The chapter identifies measures that can be implemented to deal with social and geographic divergence. The opportunities offered by the transition to a greener and more digital economy need to be shared throughout the European Union. Modernising infrastructure and preparing it for the green transition must be accompanied by further investment in social infrastructure, and particularly in the acquisition and enhancement of human capital. Improving the political and regulatory environment to stimulate entrepreneurship and encourage transformative investments is also key. In addition, support is needed for businesses to move up the value chain. The availability of finance and the administrative capacity of local authorities must also be improved if cohesion funds are to be used effectively.

Chapter 5 opens Part III of the report with a discussion of how the pandemic accelerated firms' digitalisation efforts. It shows that digital firms were better prepared for the coronavirus outbreak and have coped better with the disruption caused by the pandemic. They did better at maintaining and increasing sales, investing and accelerating digitalisation in response to the pandemic than non-digital peers. Digital firms are more productive, export more, invest more, are more innovative, grow faster and pay higher wages on average.

Rapid digitalisation is increasing the digital gap in the European Union. Digital firms are increasing their digital investment, while many non-digital, mostly small, firms are not addressing digitalisation. The failure of such firms to adopt digital technologies may have negative implications not only for their competitiveness, but also for productivity in the European Union. A lack of digital infrastructure is one of the main impediments to adopting digital technology, especially in less developed regions. Significant investment in digital infrastructure across the European Union can support a broad-based economic recovery and reduce barriers to digitalisation.

Detailed patent data map out recent patterns in digital innovation. While the European Union is lagging behind the United States and China in digital patents, the European Union leads in areas in which digital and green innovation meet, as well as in automotive technologies. This leadership is enabling traditional sectors, such as the automotive industry, to enter a new era. The analysis in Chapter 5 also discusses the contribution of digital technologies to the European green transition and to healthcare. To improve its performance in digital innovation, the European Union needs effective public policies that incentivise investment in the digital transformation and in solutions to address the COVID-19 crisis and the green transition.

The report concludes with an overview of the strategies developed to deal with climate change. European climate policies have evolved significantly in recent years. In parallel, substantial public funds are being directed to climate investment through the Recovery and Resiliency Facility. The changes

that such policies will bring for our society and economic activity are profound, and they will require significant adjustments to how we live and how businesses operate. Chapter 6 takes stock of existing and upcoming climate change policies, and discusses corporate and local government strategies to accommodate the effects of climate change and the green transition. The discussion is based on survey data from the climate module of the EIBIS and the EIB Municipality Survey.

EU firms' carbon strategies are an important part of the adjustment of business activity to the green transition and the challenges of climate change. An essential factor in these strategies is how firms perceive climate risks. Firms that are aware of climate and transition risks are more likely to invest in climate change measures or to plan such investment in the near future. Green management practices, such as energy audits or setting and monitoring decarbonisation targets, also play a decisive role in firms' strategies. The availability of finance, uncertainty about regulation and high investment costs also significantly influence EU firms' carbon strategies.

The transformation of the financial sector to facilitate finance for climate change projects is another important step in the green transition. The amounts invested in green bonds are growing continually every year. Yet they make up a small fraction of the funds needed for investment in climate change measures. If the overall returns on investment in climate-friendly activities are higher than on investments elsewhere — in other words, if there is a green premium — then investors will direct even more funds to these activities. While this report finds some evidence that a green premium exists, further efforts are still needed to ensure that climate-friendly investment financing is priced in line with the benefits brought to society. Those efforts include everything from creating standards for such investments, such as the **EU taxonomy** for sustainable activities, to putting a price on the greenhouse gas emissions of all economic activities.

A successful transition to a net-zero carbon economy will rely heavily on innovation. The world's carbon budget is depleting rapidly, and without radically innovative solutions the ambitious targets for reducing greenhouse gas emissions will be difficult to achieve. The European Union is leading the way in green innovation in several important sectors of the economy, as discussed in Chapter 6. Maintaining and capitalising on this leadership could bring enormous benefits for the planet and for the EU economy.

The report offers many compelling results and findings that are worth exploring. This brief introduction gives only a flavour of the range of topics discussed. It serves as a roadmap that guides readers towards the topics and analyses of specific interest to them.

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. Although the groups are defined by their geographic location, the countries within each group share many common structural economic characteristics, which is why the use of regions provides a meaningful basis for our economic analysis.