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Re-igniting investment in CEEs

Investment remains at the top of the policy agenda in Europe. EU funding, both grants and financial instruments, is providing a significant contribution to public investment in the CEEs, helping to mobilise private investment, strengthening national, and local authorities, and civil society.

What is the magnitude of the financing and investment gap in the CEE region?

Investment in the CEE region has been above the EU average, fluctuating around 20 - 25% of GDP with humps in the late 1990s and before the crisis. Still, some factors suggest a significant investment gap.

First, the capital endowment of CEE economies remains well below the EU average. Hence, as these countries converge to their economically more advanced peers, a prolonged period of higher investment to GDP ratios appears necessary.

Second, the investment ratio is still below the pre-crisis level in a number of countries. The part of crisis-induced fall in investment may have been structural, with implications for the capital stock and potential growth. The crisis brought rising uncertainty, increased risk premia and a reversal in external funding, which have not fully recovered.

Third, following the transition period, and in readiness for EU membership, the region undertook far-reaching reforms, which made it more attractive for investment capital. However, more recently, reform progress has slowed, or even reversed. The region's success in attracting private (including foreign) capital and in absorbing EU structural funds is key for a transition towards knowledge based economies, increasingly specialised in high value added goods and services.

Are there differences across countries and across sectors?

There are some large differences, determined by both regional and idiosyncratic factors. To take one example, total investment in the Czech Republic has stood 5 pps above the EU average due to the weight of the manufacturing sector in the economy, which requires high equipment investment.

At the same time, although being a transit country places great demands on the country's infrastructure, investment in this area has been below EU average levels.

Do the current financing models in the region need to evolve? How?

Within the CEE, as in the EU, most financing is through banks. Equity and corporate bond financing is limited, institutional investors tend to be much smaller than in Western Europe and the CEE Region have lower access to venture capital. The development of capital market financing via Capital Market Union is thus particularly important for the EU CEE Member States.

The composition of investment has also tended to tilt towards tangibles. Increased investment in intangibles such as human capital and research would support technology uptake and increase innovation, notably by domestic SMEs. This is key to improve productivity and long-term growth that would benefit society as a whole.

What are the main challenges that need addressing in this perspective?

I would say that the three most important challenges facing the CEE countries are:

- reducing administrative and regulatory burden that tends to hamper investment, particularly for SMEs.
- fostering public sector efficiency, digital innovation and the quality of institutions. This would help to establish a predictable framework and reduce uncertainty.
- investing in education, skills and new talents. The lack of adequately skilled staff is a key obstacle to many investments, including in innovative and technological companies. ●