Fostering long-term investment in the EU green and digital transitions

Introduction

Several points emerged from this discussion: Despite the implementation of NextGenerationEU (NGEU), investment remains very weak in Europe. The right way to restore competitiveness is supply-side economics, not tax policy. Rewarding risk-taking, encouraging equity financing, developing European projects financed by European companies, tackling the skills shortage and the high cost of energy are all essential elements. In addition, carbon pricing and the EU carbon border adjustment mechanism should give the right incentives for sustainable investment in the EU and beyond.

1. Despite the implementation of NGEU, investment remains very low in Europe

1.1 Investment in Europe is hampered by our collective preference for an ever-expanding set of norms to tackle the future

An industry representative stated that European measures have been quite effective during Covid. The EU's measures protected the economy during a major contraction and facilitated a rebound. Today, public finance measures focus more on public financing gaps or worthwhile social goals than solutions to economic underperformance. There is an aggregate private savings surplus and the financial means to act in Europe without taking on more debt.

The EU measures do not address the right issues. Indeed, there is a collective preference for standards over risk-taking.

European citizens are mainly risk-averse, so a limited fraction of their savings is allocated to risk capital. To make matters worse, a significant share of the savings they allocate to risk capital is allocated abroad.

Several additional key structural elements explain the low equity stake of EU citizens in their domestic firms. First, the way individual savings are funnelled in Europe leads to underinvestment in equity. The pay-as-you-go pension systems common in much of Europe rob EU firms of a major source of funds, while in the US individual pension savings such as 401(k) or ERISA accounts provide equity funding to the domestic economy. Where pension funds are set up in Europe, prudential constraints skew their allocation away from risky assets.

The recent introduction of the pan-European pension plans (PEPPs) has been ineffectual. In France, the situation is aggravated by the use of with-profits life insurance products as all-purpose investments and savings vehicles. Their capital guarantees and the Solvency II prudential requirements ensure that a large fraction of the monies invested go to sovereign credit and bank refinancing instruments rather than equities. The preferred alternative financial investment vehicles offered to French investors are regulated savings products with fixed returns used by their government to finance dirigiste social policies. In Italy, the investment return, reduced taxation and ease of subscription make domestic sovereign debt the financial vehicle of choice.

The labour force is another issue. There is a contracting working age population across the Eurozone. The numbers of available workers and hours worked are declining. It is difficult for regulatory or cyclical measures to address a context in which fewer skilled workers are working fewer hours.

1.2 NGEU making a real difference on the ground is contradicted

The recovery and resilience plans are already making a real difference on the ground

A policy-maker noted that NGEU is an unparalleled solidarity initiative that includes the Recovery and Resilience Facility (RRF). The purpose of the RRF is to support the EU's growth strategy towards a greener, more digital and more just economy. As part of the initiative, all member states were required to bring forward recovery and resilience plans, including possible reforms and investments. The strategy will be fully implemented by 2026.

The European Commission has adopted a communication relating to a mid-term evaluation and review of this initiative in an effort to strengthen ambitious reforms and investment. Labour market and education system reforms are particularly important in reskilling and upskilling workers to take advantage of new technologies. Some reforms will help reduce red tape by digitalising public administration and reducing bottlenecks. Reform is also key in creating the right business environment for companies to grow and attract investment. The RRF is made up of more than €700 billion divided into grants and loans. More than €250 billion of this investment is dedicated to the green and climate strategy. More than €150 billion is allocated to the digital strategy. Implementation by 2026 will not only provide public funding but create the right environment for companies to grow. In many member states, the use of financial instruments will be key.

In the RRF, member states have begun to implement real and transformative structural reforms to address country-specific recommendations. This is a key method of building the trust that investors need, but it is not the only factor. There must also be the right incentives, with the addition of public money crowding in private investment, to ensure that public money is not solely going towards paying public debt. There is now a political agreement between the Parliament and Council on the economic governance review. New rules will enter into force by the middle of the year and reforms remain crucial. Private investment only comes when there is the right regulatory system in place.

1.3 Productive investment in the EU has not caught up despite the pay-out of one quarter of RFF funds

An official observed that the initial objective of NGEU was to close the growing gap between north and south by increasing productivity through investments. The increase in productivity is yet to be seen, though this does not mean it will never come. If NGEU meets its goal and creates a level playing field in terms of productivity, this would be a 'game-changer'.

The discussions about making NGEU permanent represent the opposite of the strategy's goal. The EU does not want a permanent subsidy mechanism, but rather to foster productivity. One problem is the lack of success in crowding in private investment. In a regular economy, private investment is significantly higher than public investment. In the EU, the shortfall from private investment can never be made up with public funds. Structural deficiencies and problems with the ecosystem must be addressed. The typical European approach is to address such deficiencies with public money, which does not lead to as large a multiplier as expected. Fiscal rules were suspended for three years during the pandemic. Even after three years without rules, the multiplier and increased productivity from investment was not seen.

In addressing the fallouts from the pandemic and advancing the green transition, the EU has fallen victim to the erroneous belief that public spending can undo structural deficiencies. Structural problems can only be resolved by structural measures. When RRPs were rushed through the Council, reform efforts relating to the green transition appeared disappointing overall. Many of the so-called 'RRF reforms' are in fact preparatory laws for investments. The positive assessment of RRPs has reduced the pressure to go beyond RRP reform agendas.

The Chair noted that the strategy is estimated to create 1.4% additional growth in 2026. It is important to consider what would have happened in the EU had a certain policy not been in place. NGEU is delivering on many reforms. Additionally, the public administration is changing the face of many member states, with EU public procurement rules helping to create a more competitive market place and with modern public administration human resource management approaches, that will contribute to a better business environment (less bureaucracy, better service). Structural reform is being delivered. In terms of potential solutions and reforms, some parties are relatively positive, whereas others note that initially promising progress has been stymied. If the strategy advances productivity, there is no need for it to become permanent. This improvement in productivity may still come at some point.

2. Main priorities to address the obstacles to the development of productive investment

2.1 The right toll to restore competitiveness is supply-side economics, not fiscal policy

A public representative observed that Ursula von der Leyen promised a green deal. Joe Biden also promised to make a deal in this regard and in terms of investments. Four or five years on, the Inflation Reduction Act (IRA) has delivered somewhat on the green side, but the European Green Deal falls short of the deal that was promised. A mixture of both public and private money can solve the problem, but the bulk should come from the private sector.

During the current legislative session in the European Parliament, insolvency law has been dealt with and some money from government bonds released. Insurance companies might invest in electricity, hydrogen or CO2 sampling. There is often more focus on getting the support needed rather than taking action. First on the agenda is attracting private money and investment. Second in terms of solutions is a focus on the capital markets union (CMU). Some work has been done on this area during the current legislative period. The Listing Act is delivering in this regard. Long-term investment funds are delivering more effectively than previous iterations, though progress is sometimes stymied by the need for a political majority. The European single access point is a good idea, but there is more to deliver to create CMU. The notion must be further developed. Variety is the benefit and added value.

The IRA discussion is unnecessarily limited to the amount of money invested in the US. New funds should not be created in Europe as long as it remains unclear how to refinance NGEU. The 'next generation' in question are required to finance the strategy but have yet to see its benefits. The figure of additional growth is mentioned clearly in the RRF, as well as NGEU itself, and there is certainly room for improvement in this regard.

At the recent Munich Security Conference, the German Chancellor was asked why Germany was not performing as well as it might be economically. He referenced the high numbers of employed people. However, the total hours worked are the same despite a higher level of employment. The private sector must be given incentives to invest in new technologies. The focus must be on the digital transition as well as the green transition. It is impossible to achieve these goals when hardware is made in Asia and software in the US, while Europe makes only the data protection and regulation. This adds value only for lawyers and consultancies.

A market expert added that the sooner public finances are brought back to order, the sooner states will regain the leeway they need to invest. Over-indebted member states must also revise the composition of public spending and carry out supply-side-oriented reforms to reinforce their production system. Success in achieving long-term investment in the green and digital transitions will be achieved through a genuine industrial policy, replete with competitiveness, trust and remuneration of the investor. The current situation is a dangerous emergency, not only due to American competition, but because of shocks from China and beyond.

2.2 Rewarding risk taking and developing European projects financed by European companies

A market expert stated that long-term investment incurs risk and demands the immobilisation of resources in the long term. Risk-taking must be rewarded; otherwise, private savings will remain liquid, and the incentive will be lost. Progress also needs to be made on CMU. More savings should be allocated from the north to the south, and this is a matter of trust.

The context has changed in a very short space of time. With shocks and a complicated geopolitical situation, it is uncertain whether inflation will start again or remain for longer than expected. The available instruments are implemented too slowly. The IRA is dangerous for European economies and has already had an effect. Projects can be financed in a short timeframe as long as local conditions relating to the assembly line or raw materials are accepted in line with US terms.

Strategic investment previously present in Europe has been changed or removed, and competition is intense. The first goal must be competitiveness; the second is trust. There is general agreement on the supply-side policy and there are instruments, such as Important Projects of Common European Interest (IPCEIs), that might allow quicker movement in this regard. Projects in hydrogen and batteries have already followed this strategy, but there must be an overarching industrial policy to allow European authorities to interact directly with companies. Success in this area requires significant investment and strong leaders in the private sector, and there are too few companies willing to be investment champions. Protectionist measures could be considered in certain sectors. Although this runs contrary to the traditional approach, this is an emergency.

The Chair commented that competitiveness is an ongoing theme at Eurofi. One way to achieve this is through industrial policy. As there is no silver bullet, it is beneficial to consider the effectiveness of various measures.

2.3 Encouraging equity financing

An industry representative pointed out that there are developments in private, public and retail money in the Nordic and Baltic regions. Since 2017, Nasdaq has brought over 255 technology companies to market and helped over 500 companies in the areas of renewable energy and biotech come to market in Sweden, Denmark and Finland. Over 30% of the flow of SME financing is from retail money, meaning that Nordic households are taking risks with their savings. This is done through intermediated savings and mutual funds. Financial literacy and education in the area of equity investment are important steps forward. It is also a matter of taxation. There are huge taxation benefits for keeping savings in equity, but the creation of tax incentives facilitates the bringing to market of founder-led, entrepreneurial European companies. Public money cannot finance the entirety of the transition, and this is a way in which private money can bring new opportunities to market transparently.

The question remains as to how to proliferate this across all European markets. CMU is a method by which the conditions for success can be understood. An environment must be created whereby people are encouraged to try and fail. This is already the case in the US.

In terms of sustainability, people around the world look to Europe as a global leader. Despite the propagation of red tape and the difficulties of geopolitics, a successful use of the single market and the ability to use policy will cement Europe's leadership in this regard. Carbon capture is not solely for new startups; it is also for existing hydrocarbon industrials to repurpose their investments. It is also not solely about reporting. It is possible to make money with engineered carbon capture systems. The facilities and investment are in place. Industrials and mining companies in the Nordic region are thinking about how to use technology and renewables to increase productivity.

2.4 Addressing the skills shortage and the high cost of energy

An official commented that, according to the EIB investment survey, the skills shortage is the key obstacle to investment in Europe. Only €55 billion from NGEU is flowing into education. Technological developments are driven by highly talented people, not by funds being moved around.

A policy-maker agreed that addressing skills shortages and supporting labour market participation is important. One reason for deficiencies in this area is the fragmented tax system in the EU. A single market in this area has yet to develop, primarily due to vested interests. There must be consideration of the alignment of interests between member states and companies in order to seek common good in the form of CMU.

There is much to do in terms of labour and upskilling. 50% of revenue in public budgets comes from labour taxation, including personal income and social security. This does not accommodate for getting workers to work more. 25% of revenue comes from consumption taxes, while another 7% comes from corporate taxation. It will be essential to reflect on the tax mix in the context of competitiveness.

An official added that another issue is high energy prices. The uncertainty created through muddled policies is the main reason why insufficient private money is attracted. At the same time as seeking investment in green energy production, energy subsidies have not been allowed to fully expire. This naturally leads to uncertainty on the part of investors. Equally important is the uncertainty around the future evolution of prices for renewables, combined with the ambiguity created by Russia still delivering gas to some corners of the EU. The EIB Annual Survey shows that uncertainty around future returns is a major obstacle to green investment. This is reinforced by subsidisation schemes, which blur the relation between costs and returns and undermine the level playing field in the single market. The distortion of price signals and competition in the EU energy market is a key obstacle to private investment, but policy-makers' attention focuses more on the US and the IRA.

If you ask anybody, "Would you rather invest in a completely safe bond issued by the European Commission, paying 3% on a 10-year bond' – at the moment – 'or invest in a risky solar power project somewhere, where we do not know the energy price in 10 years, because we do not know what the subsidies may be or the access to the grid may be?'" You do not invest in the project itself, but you invest in the bond that the Commission issues. There is no better way to explain crowding out by the public sector.

2.5 Carbon pricing and the Carbon Border Adjustment Mechanism (CBAM) support long term investment needed for green transition

A policy-maker observed that there is success on the green agenda in terms of carbon pricing. This is one of the market-based instruments utilised in Europe. It is not a regulatory, prescriptive instrument. Incentives are given to the market in terms of CO2 pricing. Work is ongoing at the global level under the umbrella of the OECF IFCMA, to find common grounds on decarbonisation policies. CBAM has been created to incentivise companies to pursue sustainability when exporting to Europe and to incentivise countries to adopt carbon pricing. The first step is to convince countries to have some level of carbon pricing or tax, following which it can be gradually increased to an adequate level.

Market-based incentives are working, although it took time for this to become evident. 15 years ago, carbon capture and storage (CCS) was the strategy of the day, with €400 million allocated. After five years, the money was given back to the budget due to a lack of action. Now, private companies in heavy-industry sectors are seeking to invest in different CCS plans and technological solutions. The innovation fund is worth €3.4 billion and energy-intensive industry appears to be taking the idea seriously. One of the largest companies in South Korea has observed that BMW, a private company, already has stricter standards for aluminium production than the EU.

There must be an effective balance struck between regulatory instruments, market-based instruments and tax incentives in this area. The IRA poses several challenges. In Europe, there is a significant focus on subsidies. Tax credits are offered in some countries, but there is a fragmented market. It might be possible to work more on transferable tax credits or accelerated depreciations alongside structural reform efforts.

2.6 Adding protectionism to European public debt is not the correct way forward

An industry representative stated that adding protectionism to European public debt is not the correct way forward. Even in the form of import duties or a carbon border tax, this confuses promoting worthwhile social goals with the pursuit of growth. Part of the solution will be upskilling the labour force. The past 50 years of indiscriminate migration from failed states outside of Europe does not work economically or socially. In the coming election, it will likely become clear that it also does not work politically. A possible route forward is enlargement, bringing more workers to Europe. The next Commissioner must be dedicated to streamlining rather than adding to regulation.

The Chair summarised that there is a broadly convergent view on the objective of regaining competitiveness. The strength of Europe is in its economy. The organisation must be convincing in its economic terms, with competitiveness at the centre. The divergence in opinion is on how to regain this competitiveness and what its purpose should be. Innovation is an important element and there are a variety of policies under consideration, from capital markets to taxation and subsidies. Much has been achieved already and there is more to do in the future.