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A circular arrangement of twelve blue stars, representing the European Union flag, positioned to the right of the text 'The EU bank'.

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Towards a new growth model in CESEE

Convergence and competitiveness
through smart, green and inclusive
investment

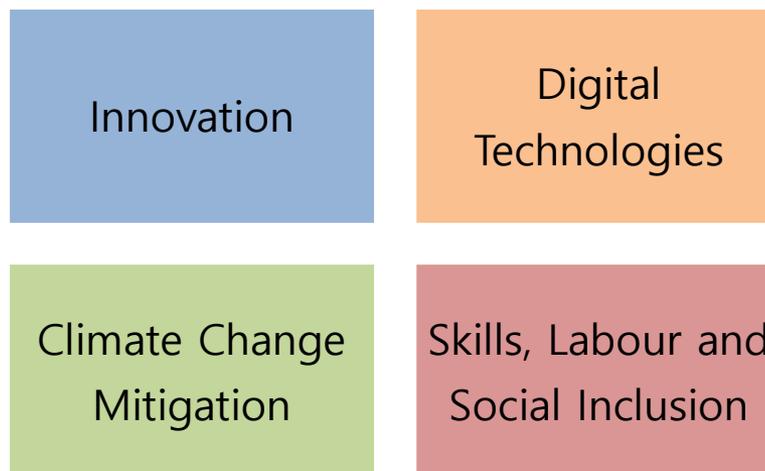
Agenda

- ▶ The need for a new growth model for CESEE
- ▶ Elements of a new growth model
- ▶ How is the region positioning in...
 - ▶ ...innovation
 - ▶ ...digitalisation
 - ▶ ...climate change mitigation
 - ▶ ...skills and labour market
- ▶ COVID impact on CESEE
- ▶ Concluding remarks

The need for a new growth model

- ▶ Post-accession convergence: was based on low labour costs, the role of exports, and capital inflows intermediated through foreign direct investments.
- ▶ Conditions have changed since then. While CESEE economies showed a robust recovery post-Global Financial Crisis (GFC), they have also faced:
 - ▶ more sluggish private investment activity;
 - ▶ lower TFP growth;
 - ▶ bottlenecks on labour markets
 - ▶ financing constraints.
- ▶ The petering out of the old growth model may cast the shadow of the middle-income trap over the countries of the region in a worst-case scenario.
- ▶ Countries in the region need a new growth model to propel growth and convergence looking ahead.

Elements of the new growth model for CESEE

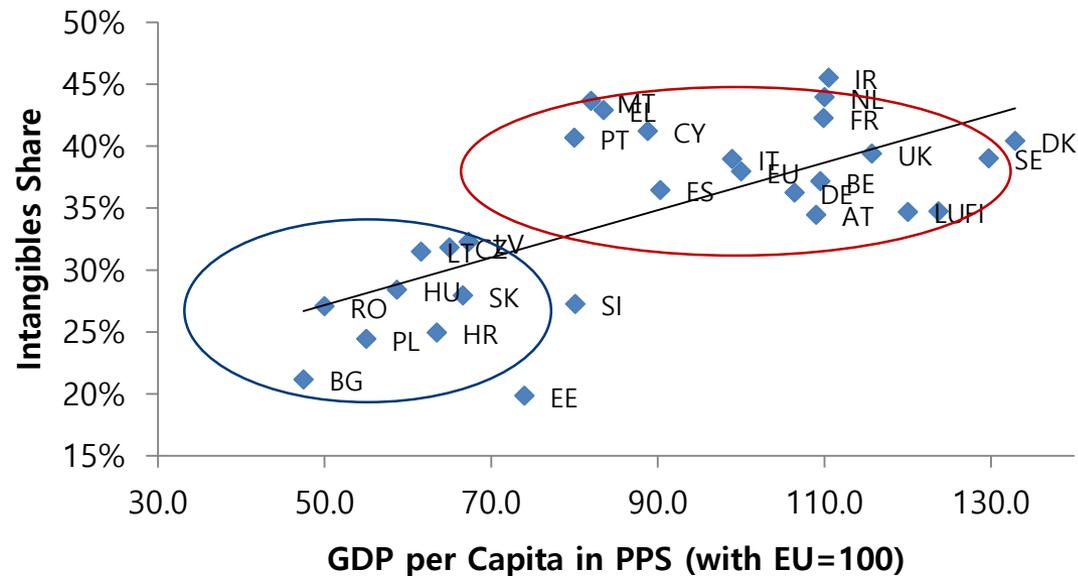


- Using mainly firm-level data from EIBIS, we assess the state of each pillars in CESEE.
- We discuss the challenges and opportunities for transitioning towards the new model.
- We look at the impact of the global COVID-19 pandemic in this context on the region.

Innovation

- After a certain level of development, long-term convergence can only be achieved by creating, rather than importing, technology.
- Home-grown innovation needs to gradually take over the role of technology import in CESEE.

Correlation between GDP per capita and share (%) of intangible investment in total corporate investment, 2017

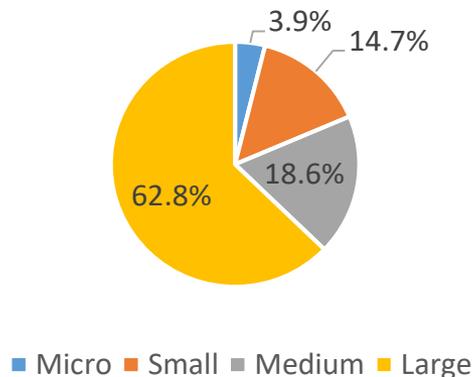


Source: EIB Investment Survey, Eurostat

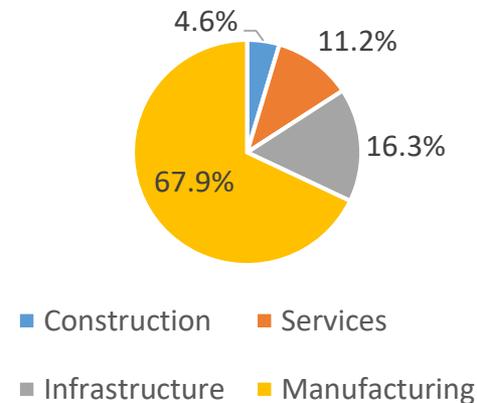
Innovation

- Currently, most countries in the CESEE region are still regarded as modest or moderate innovators.
- Innovation activity in CESEE countries is primarily driven by large manufacturing firms.

CESEE - Active innovators by firm size, 2020



CESEE - Active innovators by sector, 2020



Source: EIB Investment Survey, 2020

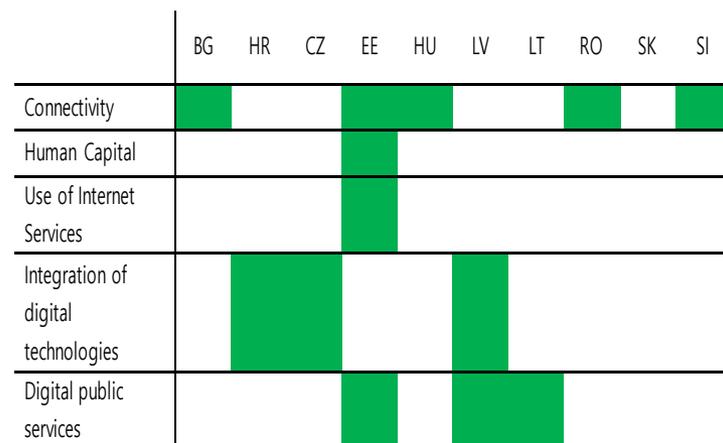
Note: Active innovators refer to those that spend actively on R&D and fall into the categories of leading innovators, incremental innovators or developers

- There are strong discrepancies by country, but also some encouraging signs.
- More corporate investment to innovation than 4 years ago.
- Key constraints: lack of innovation ecosystems, staff with the right skills, finance.
- It is necessary to increase the access to growth risk capital, particularly at mid-stage.
- Need to build on the lessons from regional unicorns (Skype, Allegro, UiPath, LogMeIn, Avast).

Digitalisation

- On overall digital competitiveness, most countries in the region lag behind the EU average.
- Still, several CESEE countries in fact score above average on connectivity infrastructure.
- Most countries fall behind in the use of internet services and the development of human capital to support digitalisation processes.
- On average, firms in the CESEE region are on par with the EU when adopting digital technologies.

Digitalisation in CESEE



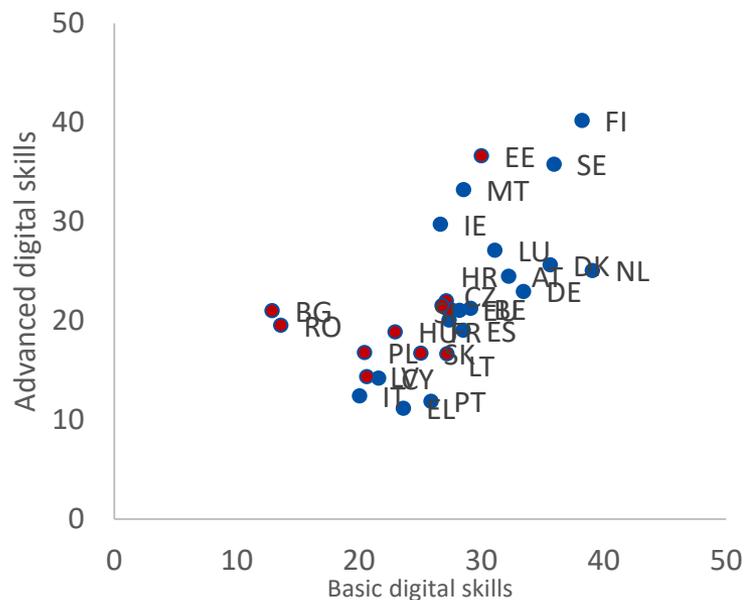
Note: Fields marked in green indicate that the country scores above the EU average in the respective dimension.

Source: European Commission, DESI (2020), EIB ECON.

Digitalisation

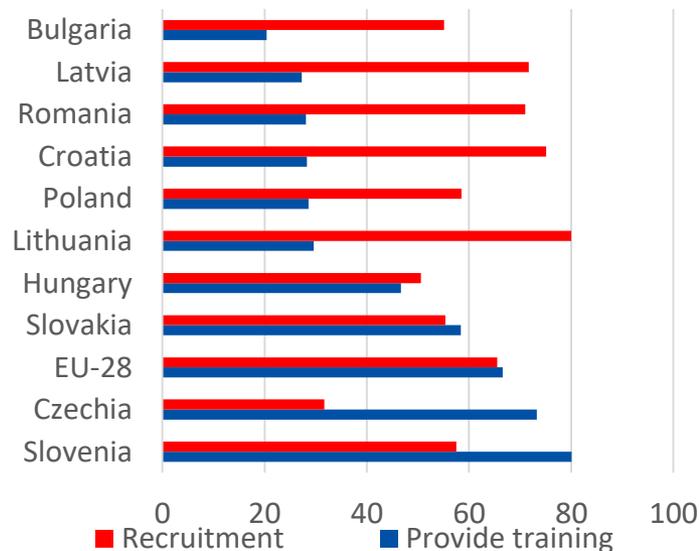
- Digitalisation adds to labour market challenges in CESEE as some jobs are being lost and new skills need to be learned.
- Basic digital skills are crucial in determining the overall labour market impact of digitalisation.
- Constraints in digital skills can skew firms' investment to labour-saving digital technologies.

Basic versus advanced digital skills in EU countries



Source: European Commission, own calculations.

Usual reaction to future skill needs



Share of firms stating to react to future skill needs via recruitment and/or training.

Source: CVTS (2015).

Climate change mitigation

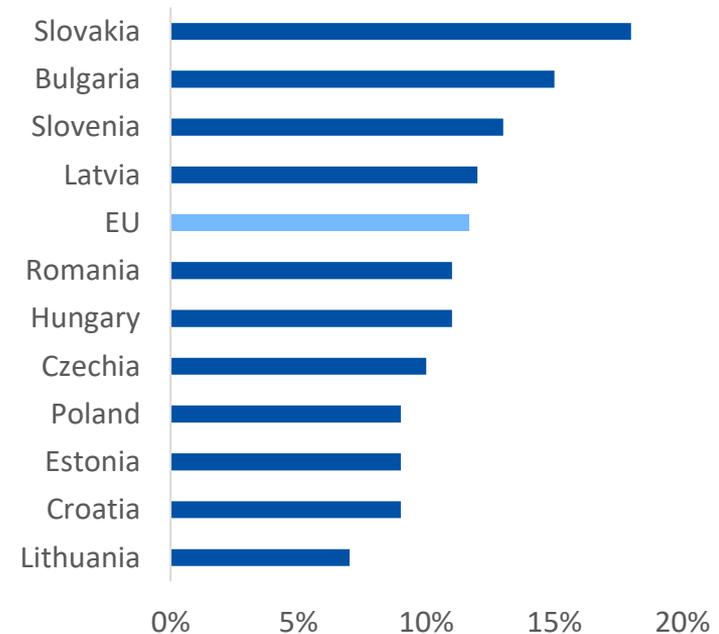
- Despite the positive developments over the last decades, there is still much to improve.
- CESEE firms spend around 10 per cent of investment to improve energy efficiency, in line with the EU, but with important differences within the region.

Energy intensity measured as total energy consumption relative to GDP (kgoe per EUR 1 000)



Source: Eurostat

Share of investment dedicated to energy efficiency improvements, CESEE countries and EU

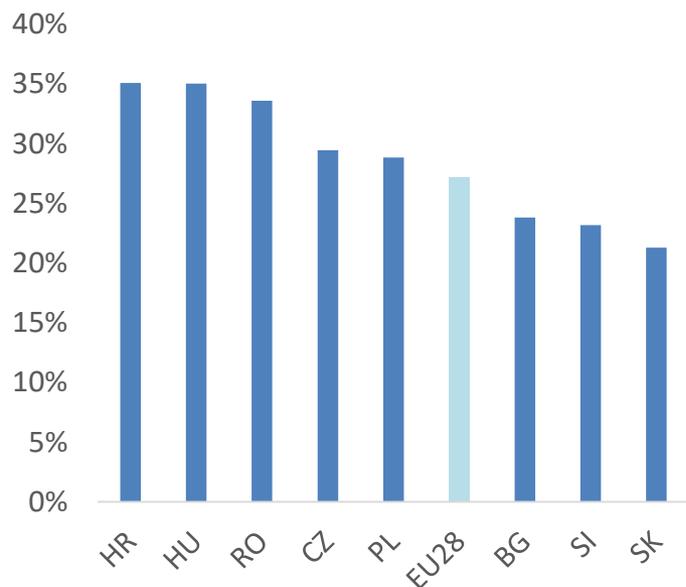


Source: EIBIS 2020

Climate change mitigation

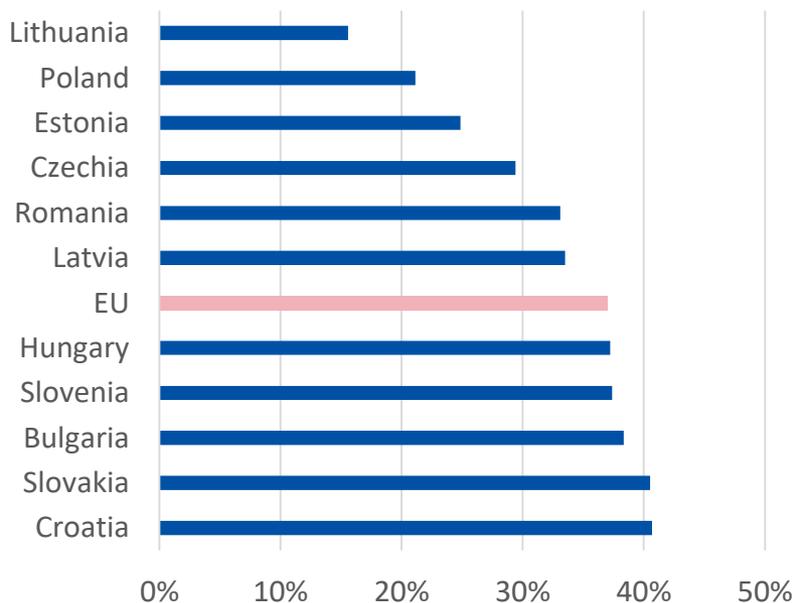
- One area with opportunities for large-scale energy efficiency gains is the building stock.
- Firms stating that their building stock meets high efficiency standards is below the EU average.
- Households account for 25-35 per cent of energy use, 75% of that is used for heating. Yet, many households in the region are not able to heat well their homes.
- More - and more innovative - financing support, is key to tap the potential energy saving in the CESEE residential sector.

The share of households in final energy consumption in CEE (2017)



Source: Eurostat

Average share of building stock meeting high energy efficiency standards, CESEE countries and EU

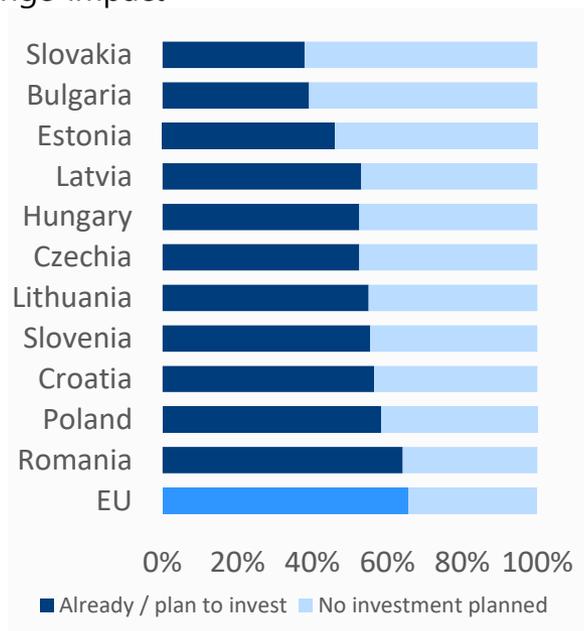


Source: EIBIS

Climate change mitigation

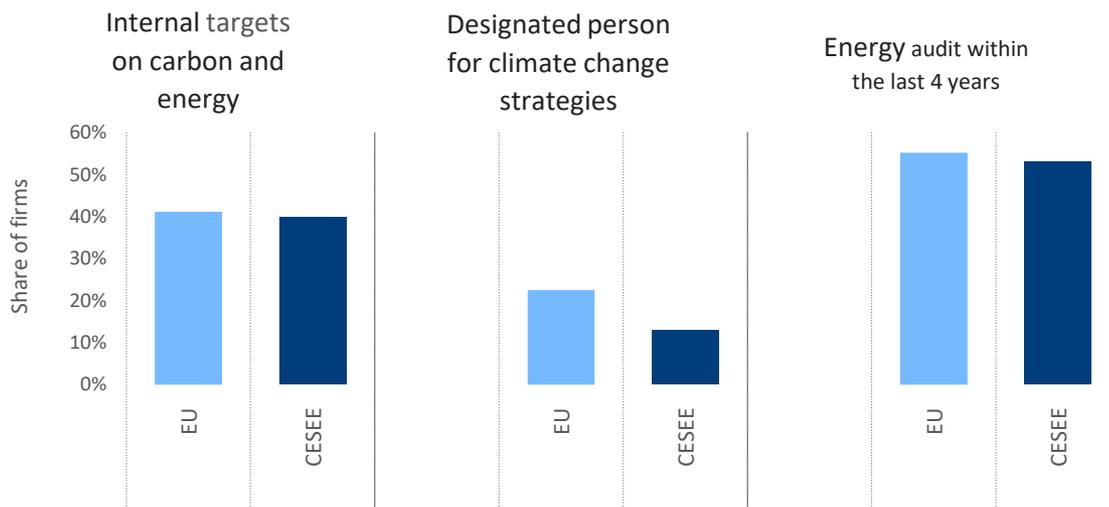
- CESEE countries have opportunities for renewable electricity generation but differentiated strategies are needed: solar in BG, RO, HU, wind in CZ, PL, geothermal in HU.
- Electrification of the individual transport fleet, together with the upscaling of community transport systems should be prioritised.
- Many firms plan to tackle climate change – but the share of firms investing in energy efficiency remains below the EU average. Support will be needed to turn investment aspirations into climate action. Management and internal procedures can support at firm-level.

Share of firms with investment plans to tackle climate change impact



Source: EIBIS 2020

Share of investment dedicated to energy efficiency improvements

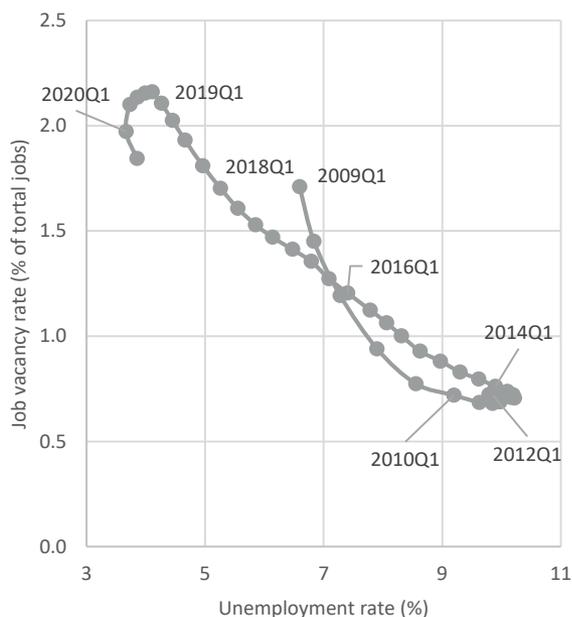


Source: EIBIS 2020

Skills and human capital

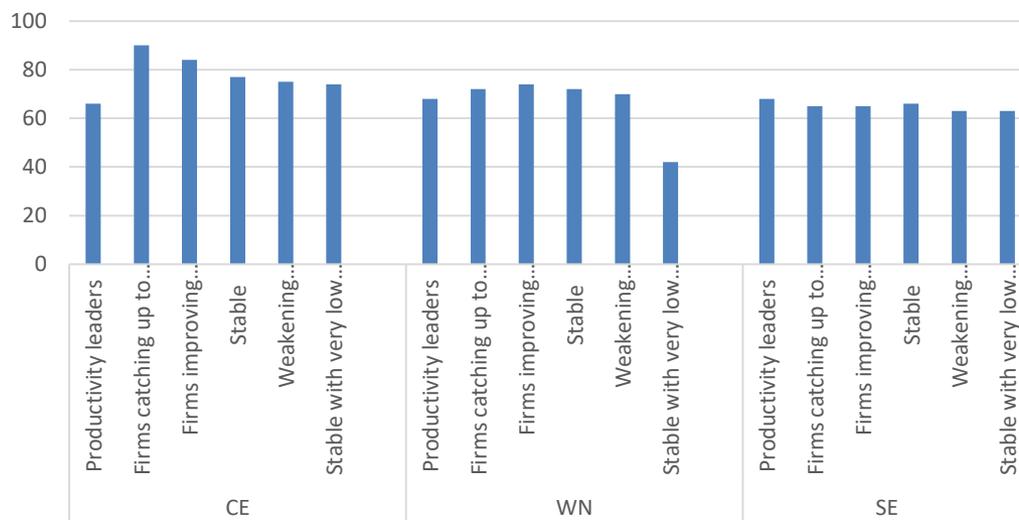
- The labour force has become a key constraint to investment and growth in CESEE.
- Firms – innovative ones and those catching up in particular – have been facing increasing difficulties in finding personnel.
- Reasons: demography, emigration, strong rebound after the financial crisis, sectoral shifts.
- Unused reserves of labour still exist in most CESEE countries but require support for activation.

The Beveridge curve in CESEE



Source: Eurostat

Share of firms reporting skill constraints (%), by productivity performance and country group

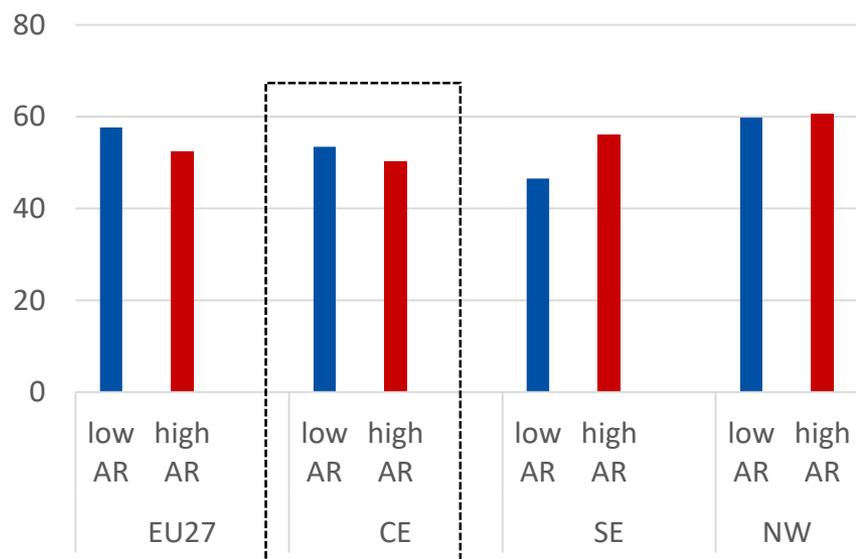


Source: EIBIS. Categories refer to the dynamics in firms' productivity performance for three country groups in the EU (CE=Central and Eastern Europe, WN=Western and North Western Europe, SE=Southern Europe).

Skills and human capital

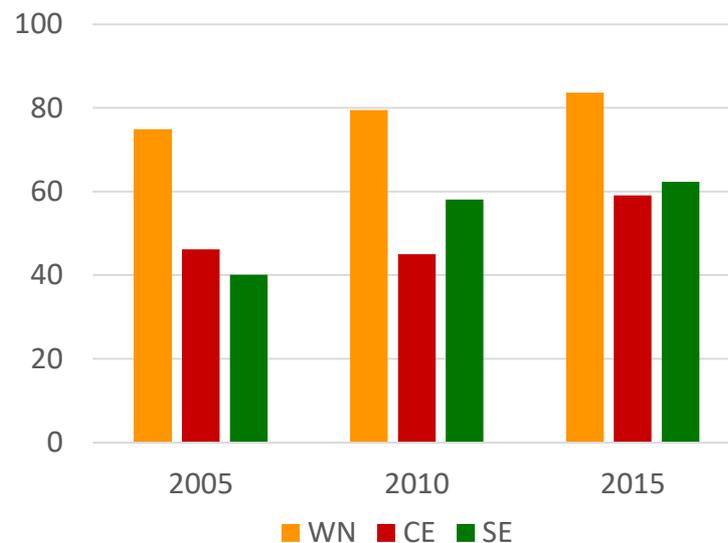
- Investment in human capital is needed to prepare the workforce for changes (digitalisation, climate) and avoid deepening of socio-economic divergences.
- Access to training and learning opportunities remains key for the region to support further convergence.
- Fewer firms invest in training of workforce, especially in regions with high job automation risk.

Share of firms investing in training investment, by automation risk exposure (in per cent), for the European Union and country groups



Source: EIBIS. CE=Central and Eastern Europe. SE=Southern Europe. NW=North and Western Europe. Unweighted shares of firms reporting any investment in training.

Share of firms providing training (in % of all enterprises), by EU country groups

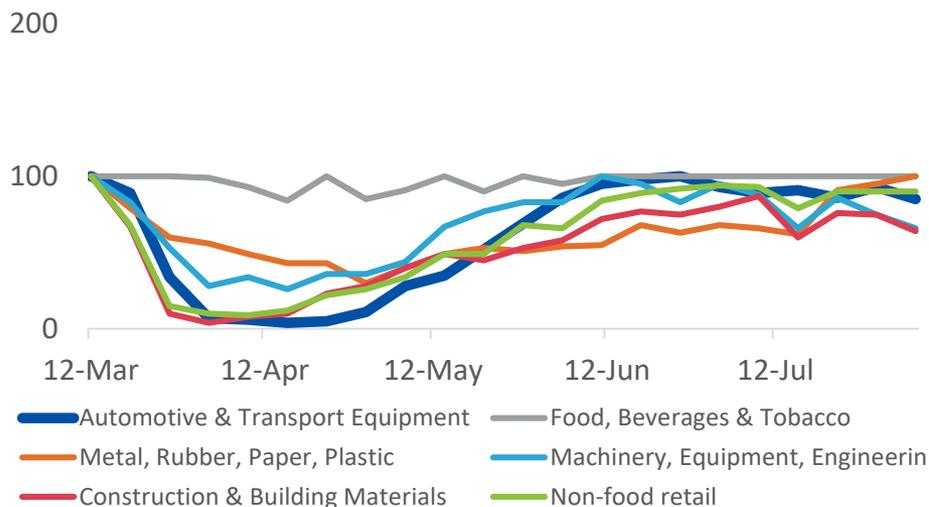


Source: Eurostat, CVTS

The COVID-19 shock and its implications

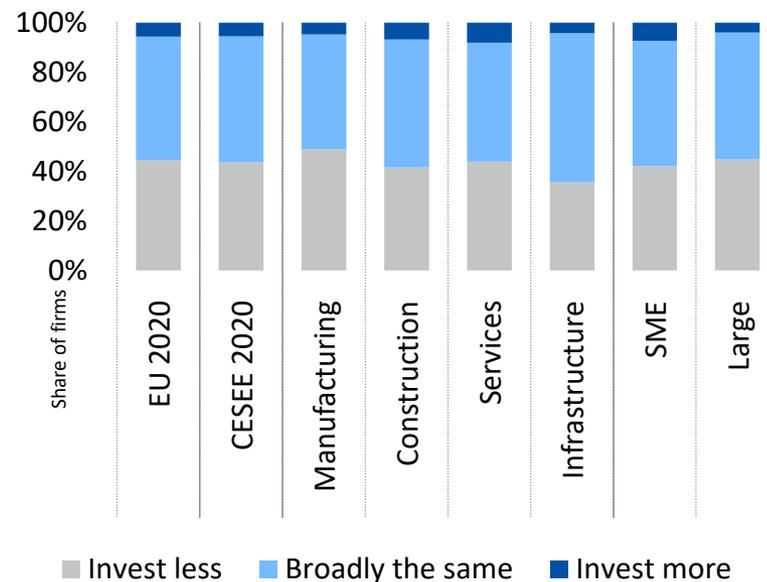
- The COVID-19 pandemic constitutes an unprecedented economic shock for the CESEE region amplifying some of the structural challenges that the CESEE economies are facing.
- The impact of the pandemic is heterogeneous. Automotive in CZ, HU, SK. Tourism in HR and BG.
- A strong impact on investment with risks remaining.
- For corporates, uncertainty, low cash flows and debt burden will strengthen the negative impact.
- Role of Public investment to compensate for the decline in private investment.

Operations of European supply chains relative to full capacity (%)



Source: Shippeo. Index based on live operation status data for more than 3000 plants and warehouses in Europe and thousands of associated transportation flows.

COVID-19 impact on firms' investment plans

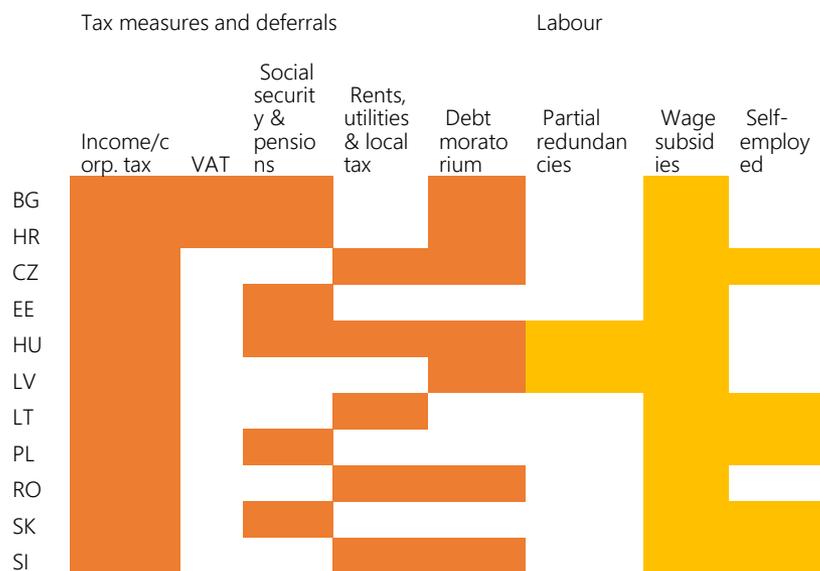


Source: EIBIS 2020

The COVID-19 shock and its implications

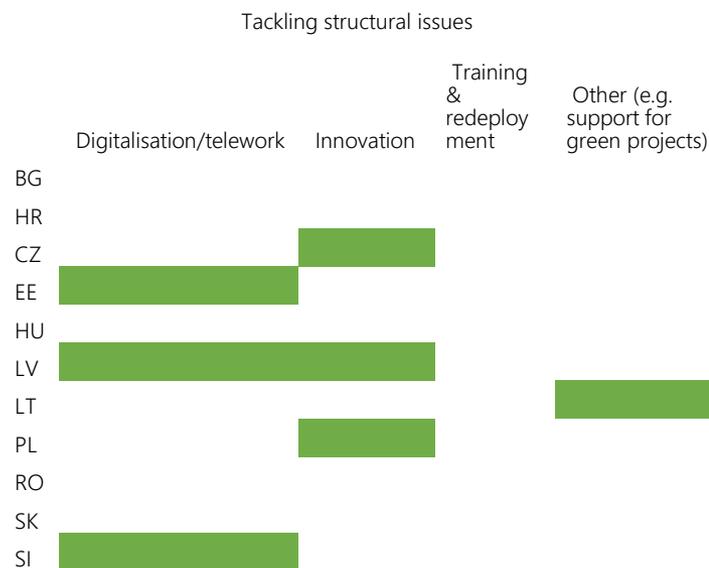
- The shock showed the role of digitalisation in competitiveness, and the risks of lagging behind.
- CESEE countries can expect a strong impact of on labour markets, with negative repercussions on human capital formation and inclusiveness.
- As to climate change mitigation, the pandemic opened a chance to break with old bad habits.
- Following on swift policy responses, forward-looking strategies for recovery are needed.

COVID policy responses with a focus on corporates and households



Source: OECD, IMF, EIB ECON. As of June 2020.

COVID policy responses with a focus on structural issues



Source: OECD, IMF, EIB ECON. As of June 2020.

Conclusions

- To continue the process of economic convergence and maintain competitiveness, CESEE countries need **to revisit their growth models** and move **towards a more innovation and knowledge-based framework**.
- The **COVID-19 shock** amplifies some of the structural challenges CESEE economies are facing.
- To boost **home-grown innovation** across the region, efforts are needed to create comprehensive innovation ecosystems, to reduce the skills gap and to improve innovation financing.
- To leverage on **digitalisation**, it is necessary to strengthen the use of internet services and the development of human capital, especially when it comes to basic digital skills.
- When it comes to **climate change mitigation**, key areas of improvements are necessary in the energy efficiency of the building stock, in renewable electricity generation, and in green individual and public transport
- **Skills and human capital** are key to a successful transition to the new growth model. It is necessary to change the labour market from being a bottleneck through investment in lifelong learning, better overall educational systems and better use of digital technologies in learning.
- **EU recovery planning provides an opportunity** for accelerating transformation towards a digital and green but also more inclusive economies.