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Panel: Policy outlook, potential growth and policy issues

Investment in the new Member States: What should be the future focus of the CEECs and of EU policy?

14 May 2008

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Why does investment matter?

- Investment is the use of resources intended to increase future production, output or income
- Sacrificing current consumption for future return
- Private sector investment is (on average) likely to be efficient as businesses require returns
- Can expand future production potential of the economy – i.e. the long term growth rate of an economy
- All other things being equal, an economy with higher investment will have higher growth in future
- Higher value-added is associated with more capital-intensive (and human capital-intensive) production – high levels of investment required
- Future European economy will have to increasingly rely on knowledge-intensive economic activity with high investment levels

Different types of investment

Important to consider all sources of investment but difficult to clearly separate out different types of investment:

- Domestic (or resident) companies spending on investment (or Gross Fixed Capital Formation)
- Public investment (for example, in infrastructure or skills)
- Investment in innovation: Research and development expenditure
- Foreign Direct Investment
- Portfolio investment from abroad (through financial instruments)

Advantages and disadvantages

	Potential advantages	Potential disadvantages
GFCF	Future growth	Deferred consumption Construction/housing bubbles
Public investment	Enhance long term growth potential	Crowding out Misallocation of funding
Investment in innovation	Growth in high value-added sectors	Non-additionality (public) Non-market focus (public)
Foreign Direct Investment	Growth, additional capital, networks, knowledge	Dependence on external investment, external imbalance
Portfolio investment	Availability of capital, speculative gains	Volatility, destabilisation through speculation

How do the new Member States perform?

Gross Fixed Capital Formation	Higher than EU average (catch up of infrastructure etc. but in construction/housing recent difficulties)
Public investment	Higher than EU average on physical infrastructure, lower on human capital
Investment in innovation	Lower than EU average
Foreign Direct Investment	Higher than EU average (but challenged in future as wages rise?)
Portfolio investment	Lower than EU average

EU policies impacting on investment

- Economic reform/Lisbon Agenda ⇒ R&D, infrastructure, human capital/skills expenditure in MS (but also budget constraints)
- Innovation/Research ⇒ R&D expenditure (in research institutes)
- Lead markets etc. ⇒ Market for innovation to drive private R&D
- European Structural Funds ⇒ focus on Lisbon Agenda (but mainly in the old member states), still dominated by infrastructure etc. in the new member states
- Energy and environment ⇒ eco-innovation spending

Future investment strategy

- Investment in CEECs currently focused on basic physical infrastructure
- High domestic investment (GFCF) and FDI (but variable performance)
- Need to deal with short term crisis and shifts – macroeconomic stability
- Future competitive advantage shifting (from wage to ?)
- Less attractive for FDI ⇒ how to maintain inflow but attract a higher proportion to higher value-added activity
- Competition between countries and regions to be FDI recipient
- More needs to be invested in human capital and innovation
- CEECs must align more closely with EU competitiveness priorities (Lisbon)
- EU Structural Funds also need to be refocused (by the CEECs and strategically at EU level)
- More strategic and enforceable economic policy coordination?