

Foreign investors back Europe, but is Europe back?

EY Attractiveness Survey

Europe

June 2021



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The findings in this report are based on a two-step methodology that analyze the reality and perception of Foreign Direct Investment (FDI) in Europe. The reality of investment in Europe is based on the EY European Investment Monitor (EIM), an EY proprietary database produced in collaboration with OCO. This database tracks FDI projects that have resulted in the creation of new facilities and jobs. The perception of foreign investment in Europe is assessed by an online survey conducted by Euromoney in March and April 2021, based on a representative panel of 550 international decision-makers. In addition, this report contains views and insights from EY professionals and other stakeholders.



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Foreword

2020 was characterized by a global pandemic, a new US President, a last minute trade deal between the EU and the UK, coupled with sharp declining GDP across the globe, leading to over 12 million job losses in Europe alone. All of these factors resulted in an unprecedented stimulus package to rescue Europe's economy.

This is not exactly the stability that investors crave. But, despite the unprecedented circumstances, foreign investment in Europe only declined by 13% in 2020 and is expected to rebound swiftly. And although investment was down overall, some areas actually fared very well. For example, investment in the life sciences sector surged 62%, and the number of logistics projects increased 11%.

Amid the volatility, investment in Europe is relatively resilient because it is perceived to be a stable environment that has the fundamentals that investors need: an abundant supply of skilled labor, robust infrastructure, political stability and a large addressable market.

But, Europe cannot be complacent. COVID-19 has elevated the importance of a number of factors that influence location decisions. Take skills, for example. Businesses have always located their operations in areas where there is an abundance of talented workers. But COVID-19 has accelerated businesses' digital strategies and, as a consequence, their need for digital competencies. In addition, the survey data reveals that 9 in 10 businesses consider environmental sustainability to be an important factor that determines their investment strategy.

This raises a key challenge for European policy-makers: can they cater for businesses' new and changing priorities while also continuing to get the fundamentals right? Can they use the crisis as a catalyst for change to create a better Europe?

Encouragingly, our report reveals that there is a significant opportunity to reframe Europe's attractiveness. For example, the EY organization has identified 1,000 "shovel-ready" green projects that could create three million jobs, almost a quarter of the number lost due to the pandemic.

The EU has shown its cohesion and collective strength in devising and implementing its vast economic recovery

stimulus. This is a radically different approach to the fiscal prudence adopted immediately after the global financial crisis. As we explore in this report, the EU's Recovery and Resilience Facility (RRF) targets the areas that are featuring more prominently on potential European investors' agendas: Innovations in technology and sustainability. Although businesses are naturally sceptical about the impact of big government initiatives, and it will take some time for the funding to be released, the size and scope of the packages will contribute to Europe being an attractive destination for foreign investment in the long-term.

But Europe is by no means out of the woods. Unfortunately, concerns about geopolitics, trade tensions and new regulation have risen to the top of the agenda as factors that could undermine Europe's attractiveness. Governments should take note.

This is why collaboration between multiple stakeholders is key to fortifying Europe's competitiveness on the global stage. Individual countries, both within Europe and beyond, must work together to calm geopolitical tension and reach consensus on issues such as how to tax digital businesses. Governments, academia and businesses must collaborate to ensure that Europeans are equipped with the skills that businesses will need in the future. And governments must also collaborate with the scientific community, businesses and wider society to promote environmental sustainability.

It's imperative that Europe does what it takes to cement its perception as an attractive investment destination. After all, foreign investment has the potential to create jobs for those left unemployed, provide opportunities for businesses that have suffered, and revitalize regions that have been hit hard. In short, it can trigger much-needed sustainable economic growth.

We hope that the findings in this report initiate a conversation about foreign investment and Europe's future. As part of commitment to building a better working world, EY professionals are dedicated to helping businesses, sectors and countries recover, transform and thrive. We firmly believe that foreign investment has a key role to play in this endeavor.

Executive summary

1 Foreign investment set to rebound following 2020 downswing

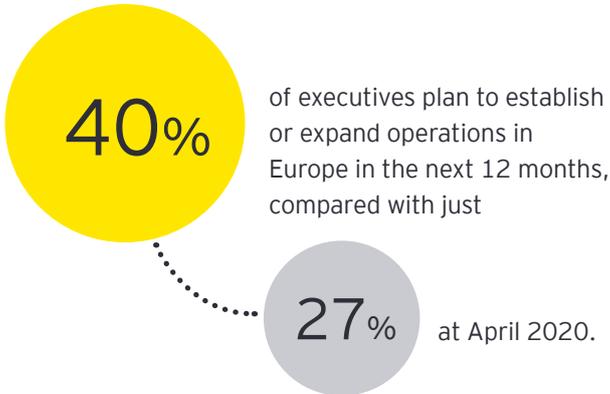
In 2020, the turbulence and uncertainty caused by COVID-19 caused foreign direct investment (FDI) in Europe to **fall 13%** compared with 2019 to

5,578

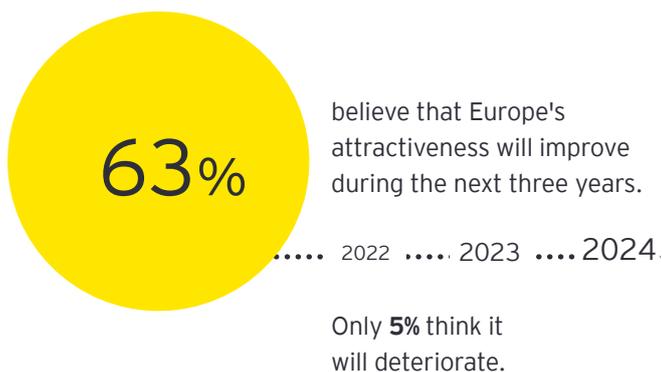
inward investment projects.

Europe has proved its resilience in 2020 because foreign businesses still see it as fundamentally one of the most stable, skilled and sophisticated regions around the world to invest for the long-term.

Investment is set to rebound this year as pent-up demand to execute projects is unleashed:

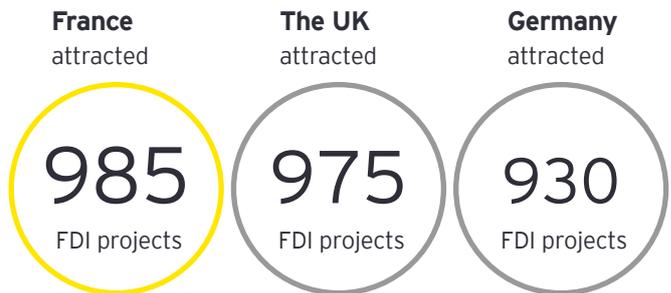


Reflecting long-term optimism in Europe as an investment destination,



2 Life sciences and e-commerce are rare bright spots for investment

Due to its relative success in containing COVID-19 during 2020, investment in Germany fell less precipitously than in France and the UK, meaning that the three are virtually tied as Europe's top investment destinations. In 2020,



Supply chain disruption, restrictions on movement, national lockdowns and uncertain demand caused **manufacturing FDI to decline**



A spike in logistics investment by online retailers that were mobilizing to cater for surging demand more than compensated for a significant decline in logistics investment linked to industrial demand.

Inclinations toward major supply chain reorganization that were present when COVID-19 first hit have evaporated:



Life sciences was the only major sector that experienced an increase in foreign investment as businesses rapidly moved to meet the surging demand for COVID-19 vaccines, treatments and personal protective equipment.

Source: EY European Investment Monitor (EIM) 2021. EY Attractiveness Survey Europe June 2021 (total respondents: 550).

3 Skills, sustainability, stimulus and simplification: the key ingredients for long-term attractiveness

Although there is cautious optimism that foreign investment in Europe will rebound, policy-makers and businesses cannot relax. Because the factors that influence location decisions are changing, the private and public sectors together need to focus on four key areas to ensure that the continent remains an attractive long-term investment destination.

1 Revamp Europe's digital skills base

Digital skills have long been mentioned as a priority for governments seeking to attract international investment. Or new role of technology triggered by COVID-19 – digital customer experiences, “phygital” work environments, and more automated production lines and back offices – makes this an absolute imperative. Tellingly, 92% of international investors say that the availability of a workforce with technology skills is an important factor that determines where they invest. Sophisticated businesses therefore monitor which universities are creating graduates with technology expertise and factor this into their location decisions. It is encouraging that EU policy-makers have put digital skills at the forefront of recovery plans. But this must happen in close consultation with industry so that skills are created that businesses actually need.

2 Cement Europe's “green leader” status

Environmental sustainability increasingly influences investors' location decisions: 9 in 10 surveyed businesses say sustainability is important to their investment strategy. Encouragingly, 85% of businesses already consider Europe a green leader. To fortify this perception, Europe must continue to support investment in the green economy. The EY organization has identified 1,000 shovel-ready green projects that could create almost three million jobs in the near future.

3 Simultaneously deploy short-term stimulus and longer-term transformation programs

Europe's economic recovery plans are on track, both at the European and national levels. Investors may rank these massive resilience and recovery plans (such as the EU's €672.5b RRF) among the least critical factors that will determine their future location decisions. But this is probably because they were, at the time our survey was conducted, more interested in short-term stimulus measures and the recovery of European economies than in the longer-term effects of digital and sustainability-related programs. Governments therefore need to combine long-term reforms with more immediate support.

4 Continue down the hard path of tax harmonization and transparency

Europe must redouble its efforts to pursue tax stability. Whether it be the work of the EU Code of Conduct Group or the enforcement of State aid rules, the use of preferential tax arrangements that undermine competition has been significantly reduced. But now the focus must shift to digital taxes. Individual countries' digital services taxes create complexity, which is magnified when businesses want to sell across all of Europe and the world. European leaders must therefore seek to reach consensus with other countries on how digital businesses will be taxed.



Source: EY European Investment Monitor (EIM) 2021, EY Attractiveness Survey Europe June 2021 (total respondents: 550).



Foreign investment set to rebound following 2020 downswing

A total of

5,578

FDI projects were announced in Europe in 2020, a 13% annual decrease

During the next 12 months,

40%

of businesses plan to establish or expand operations in Europe, a significant increase on the 27% reported in 2020 and 2019

62%

of investors expect Europe's attractiveness to improve over the next three years

1

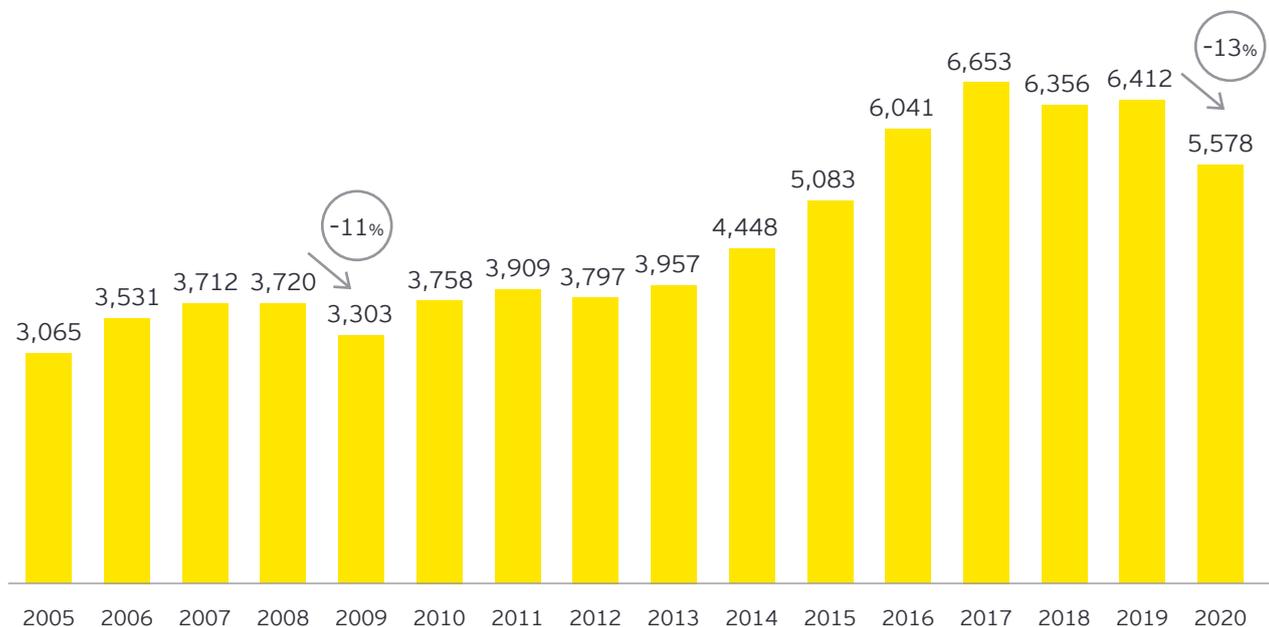
European foreign investment in 2020: down, but not decimated

Businesses from around the world announced 5,578 FDI projects in Europe in 2020, a 13% decline from 2019. This is the first time that foreign investment posted a double-digit year-on-year percentage decrease since 2009, when the global financial crisis triggered an 11% fall. Last year's drop needs no explanation. The onset of the COVID-19 pandemic

at the beginning of the year stopped investment plans in their tracks and created immense economic uncertainty.

Given the turbulence when the pandemic first hit Europe, it's remarkable that investment only declined by 13% last year. And by historical standards, investment levels in 2020 were still greater than in any year before 2016 (see Figure 1).

Figure 1: Number of foreign investment projects announced in Europe



Source: EY European Investment Monitor (EIM) 2021.

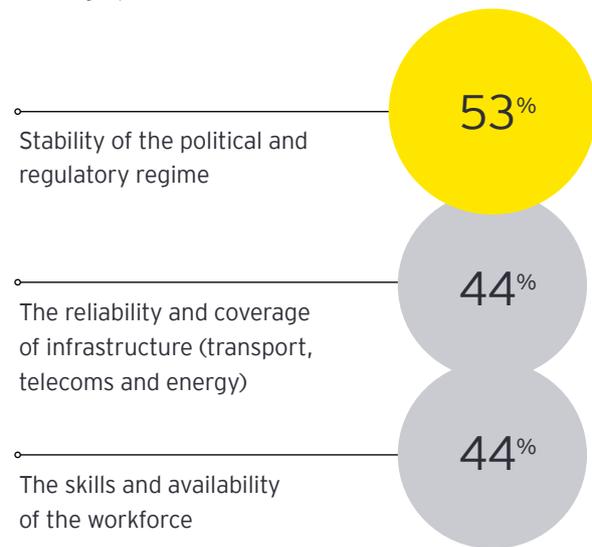
Why was investment so resilient? Despite the unprecedented circumstances, foreign businesses still see Europe as fundamentally one of the most attractive regions around the world to invest for the long-term. And why wouldn't they? Europe has a relatively stable political and regulatory regime, a highly skilled workforce and comparatively robust transport, energy and telecoms infrastructure. Following an unprecedented year, it's no surprise that surveyed businesses identify these as the three most important factors that determine where they locate their operations. And Europe has them all (see Figure 2).

Businesses are therefore proceeding with plans that they might have first developed as early as 2017. Illustrating this, 41% say their 2021 investment plans have not changed due to COVID-19, and 17% have actually increased their investment plans. Just 30% decreased their investment plans, while 11% delayed them (see Figure 3).

So, although some businesses throttled back, investment levels are still healthy given the extraordinary times.

Figure 2: Political stability, reliable infrastructure and skills sway investors

Q. In your company's future location choices, what factors may influence your decision to select a particular country?
(Only the top three choices are shown; see Chapter 3 for the full graph)

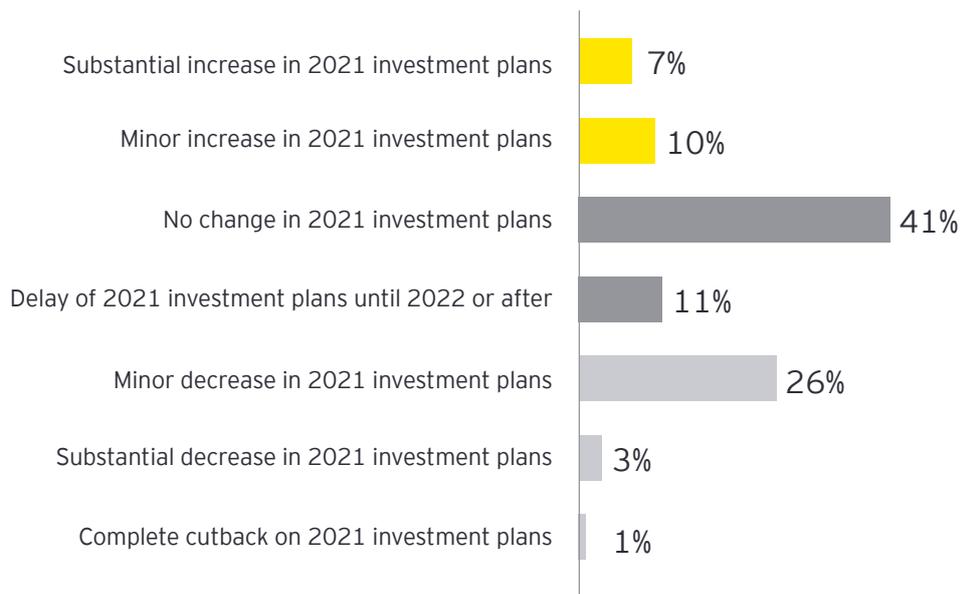


Source: EY Attractiveness Survey Europe June 2021 (total respondents: 550).

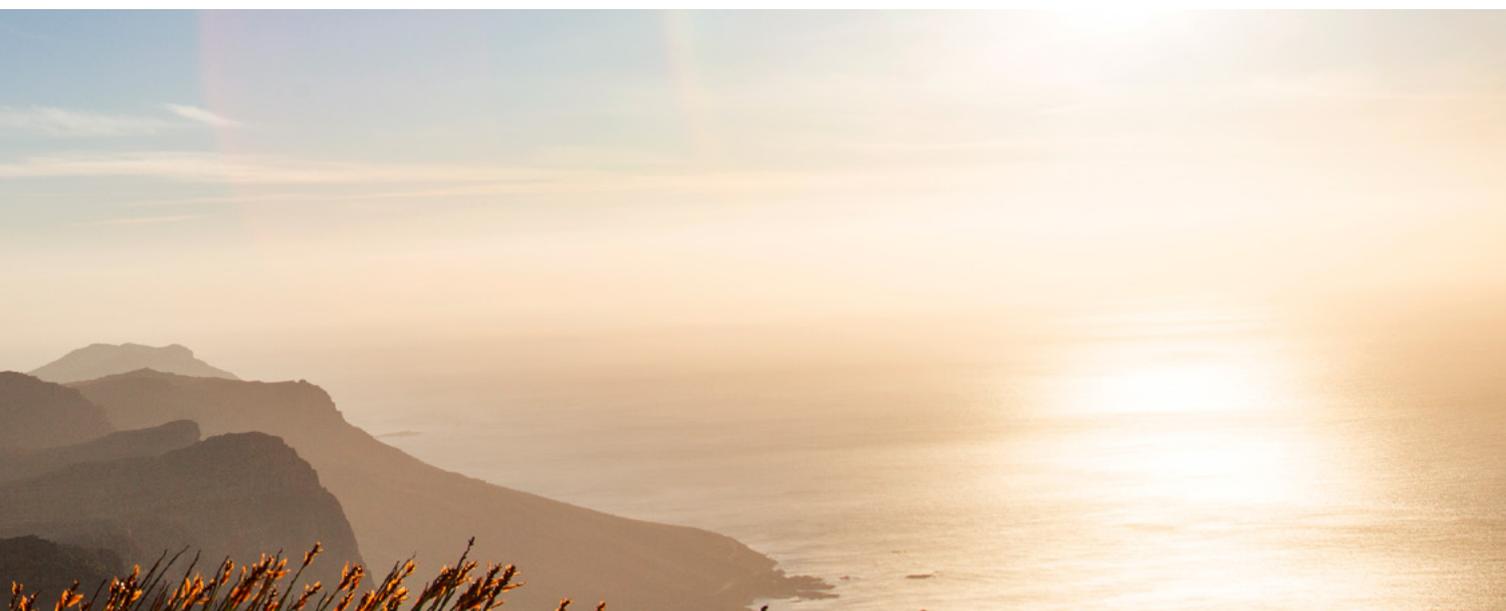


Figure 3: Foreign businesses maintain European investment plans

Q. To what extent have you changed your 2021 investment plans because of the COVID-19 outbreak?



Source: EY Attractiveness Survey Europe June 2021 (total respondents: 550).



Investment optimism is resilient, but is it sustainable?

What does the future hold for foreign investment? The long-term outlook for Europe seems encouraging: when asked which regions will be most attractive to establish operations when the COVID-19 pandemic is behind us, Western Europe ranks first, with Central and Eastern Europe and North America tied in second place (see Figure 4). In parallel, 63% of investors believe Europe's attractiveness will improve during the next three years. Only 5% think it will decrease (see Figure 5).

Businesses consider Europe to be attractive in the long-term for the same reasons that caused investment levels to be resilient in 2020: it is a large market that

has solid fundamentals of political stability, a skilled workforce and advanced infrastructure. This stability is all the more important to investors in the current turbulent environment globally.

Importantly, the survey data cannot be interpreted as a glowing endorsement of Europe's long-term attractiveness. Rather, the increase in investment appetite reflects an unleashing of pent-up demand following a year in which COVID-19 restricted businesses' ability to deliver projects. That said, it does indicate that FDI may rebound quickly to previous levels, assuming significant headwinds do not emerge.

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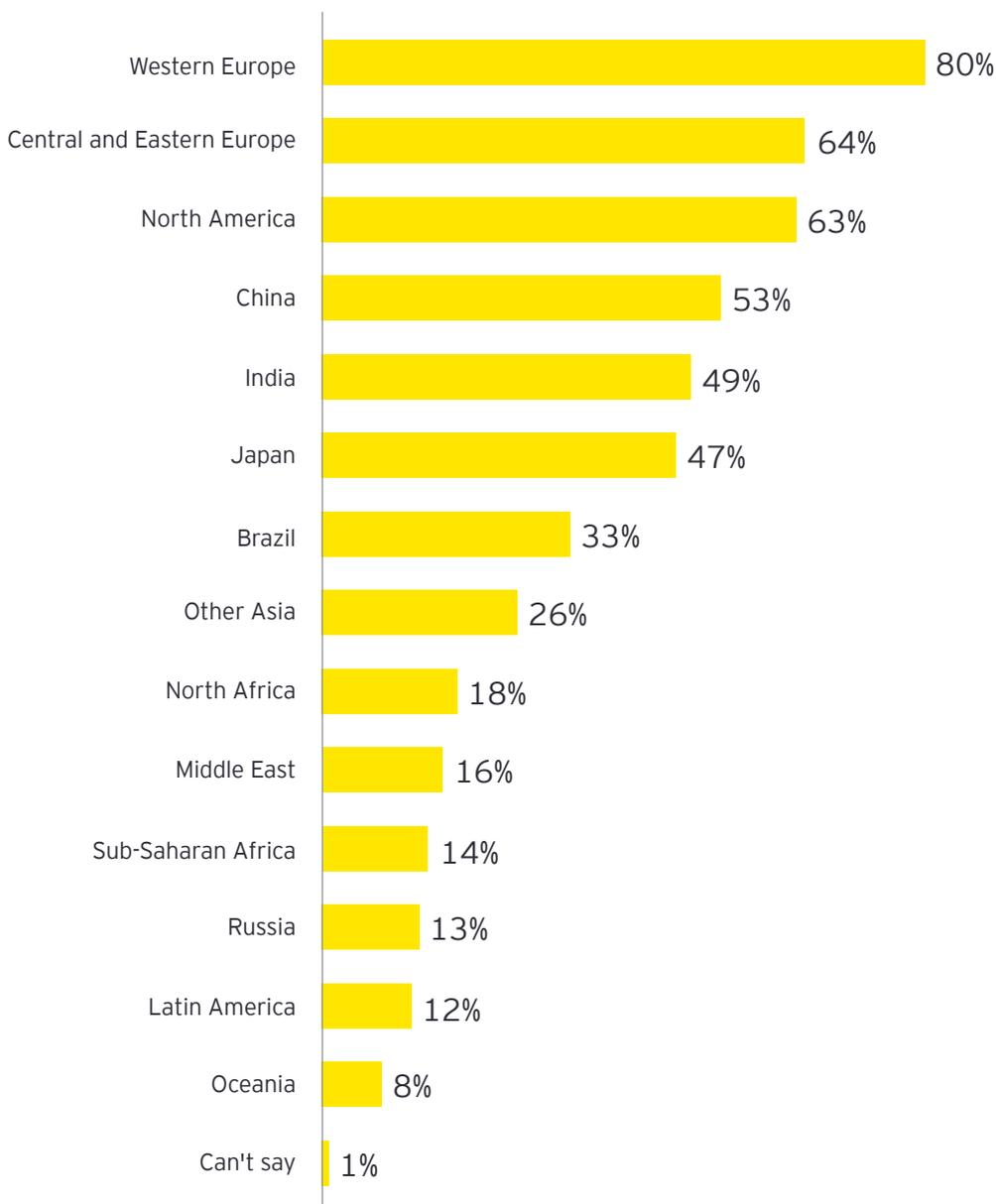
The optimism in the survey is well founded. Despite the short-term setback caused by the depth and duration of new waves of COVID-19, progress with vaccination rollouts and a relaxation of containment measures can pave the way for the organization rebound in economic activity in Europe in the course of 2021. In contrast to the global financial crisis, manufacturing and export levels have already recovered and in many Central and Eastern European countries are already above pre-pandemic levels.

Marek Rozkrut

Head of EY EMEIA Economists Unit

Figure 4: Europe expected to be most attractive for foreign investment post- COVID-19

Q. Which of the following regions do you believe will be the most attractive to establish operations once the COVID-19 pandemic is behind us? Please select your top three choices. (Note: 83% of surveyed businesses already have a presence in Europe, so these findings predominantly reflect a European view of global attractiveness.)



Source: EY Attractiveness Survey Europe June 2021 (total respondents: 550).

In the near term, the survey points to a rapid rebound: 40% of surveyed businesses plan to establish or expand operations in Europe during the next 12 months, a significant increase on the 27% that had such plans in 2020 and 2019. In fact, appetite to invest in Europe is at its highest level since the financial crisis.

The pace at which investment recovers will likely vary significantly across sectors. Investment in industries least impacted by COVID-19, including consumer, industrials, digital and life sciences, will likely recover much faster than those that remain depressed, including transport and hospitality.

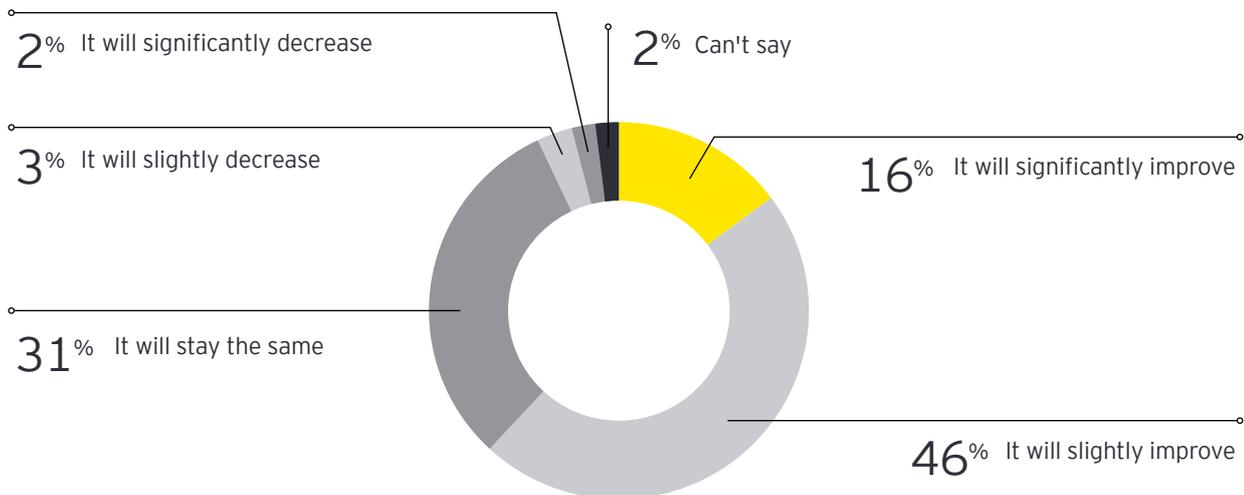
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At the forefront of all our minds right now is the pandemic and the impact of that pandemic, both in terms of financial markets and how quickly we'll recover. Fortunately, the vaccine is coming much quicker than we thought it would, so I am cautiously optimistic that we're going to come out of this faster than we hoped, than anybody would have thought.

Pravina Ladva
Group Chief Digital Transformation Officer
Swiss Re

Figure 5: Investors are confident that Europe's attractiveness will increase in the next three years

Q. To what degree do you think Europe's attractiveness will evolve over the next three years?



Source: EY Attractiveness Survey Europe June 2021 (total respondents: 550).

Headwinds remain

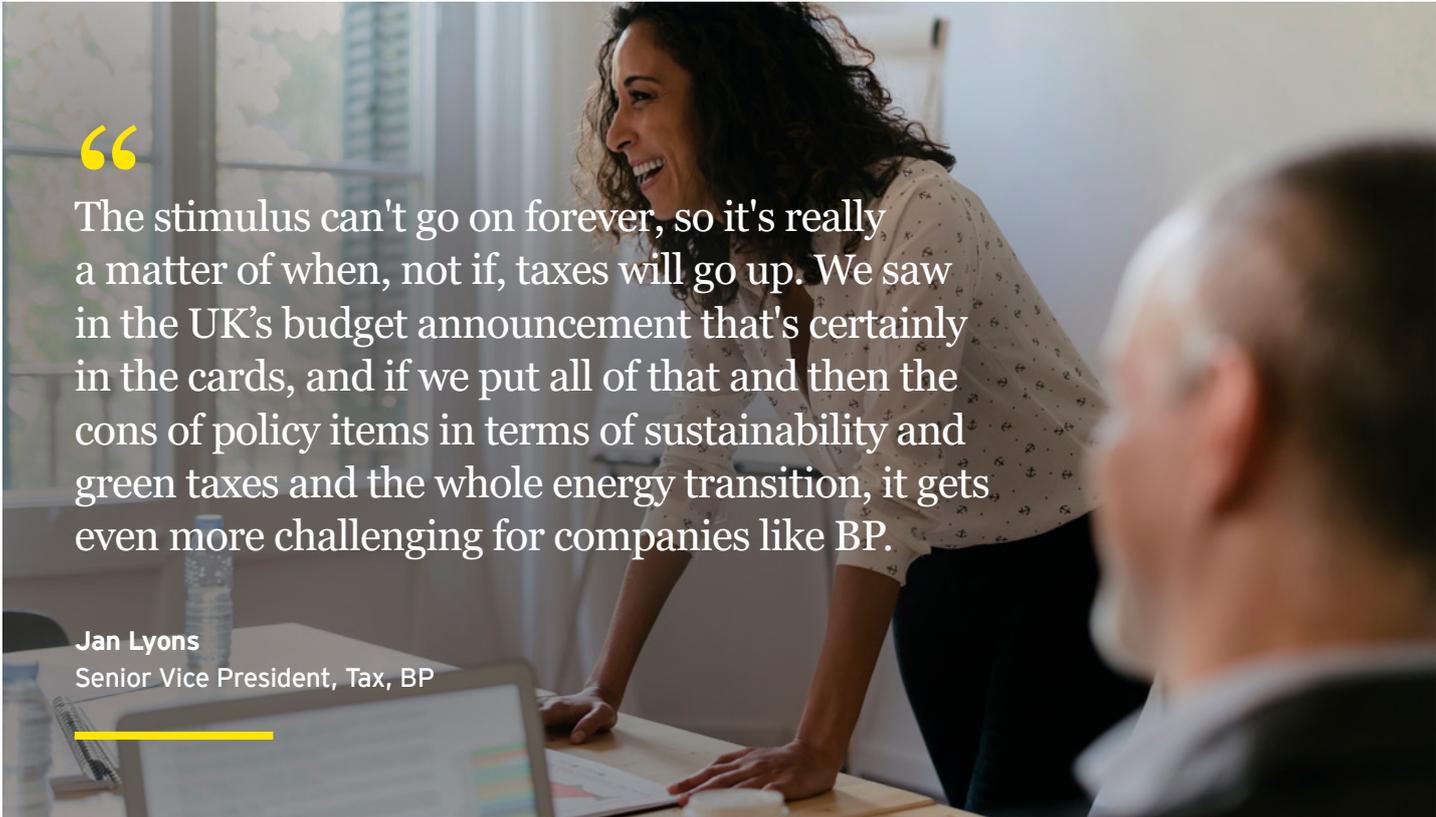
However, executives polled by EY professionals say there are a number of short- and long-term risks to Europe's attractiveness. In the short term, the vaccine-driven economic recovery could falter if new vaccine-resistant strains of COVID-19 emerge that require a return to social distancing. Economic growth and foreign investment activity could also be dampened if the curtailing of various forms of COVID-19 support happen too quickly or have a greater negative impact than previously anticipated.

Then there are longer-term threats. The survey reveals that businesses think protectionism and uncertainty about tariff and trade policies represent a greater threat to Europe's attractiveness than they did in 2020. The US's vast economic stimulus package also has the potential to attract some FDI away from Europe.

Looking further into the future, Europe could become less attractive if it falls behind in delivering what foreign investors value most:

- ▶ Stable political and regulatory regimes
- ▶ A highly skilled workforce
- ▶ Robust transport, energy and telecoms infrastructure
- ▶ Cost competitiveness

Currently, Europe performs well on all of these measures by international standards. But with other regions competing for FDI, there is no room for complacency (Chapter 3 explores how Europe is preparing to maintain its long-term attractiveness in more detail).



“

The stimulus can't go on forever, so it's really a matter of when, not if, taxes will go up. We saw in the UK's budget announcement that's certainly in the cards, and if we put all of that and then the cons of policy items in terms of sustainability and green taxes and the whole energy transition, it gets even more challenging for companies like BP.

Jan Lyons
Senior Vice President, Tax, BP

Strategic risks in focus: investors wary of simmering geopolitical, regulatory and trade tensions

Despite the current optimism surrounding Europe, investors are concerned about global and local political risks (see Figure 6). An EY survey of global executives confirms that political risk is top of the agenda¹: 94% say that their company was impacted by unexpected political risks at least some of the time in the past 12 months and, over the next 12 months, 49% expect the effect of political risk on their company to be higher than it is today.

The COVID-19 pandemic has accelerated many existing trends, including greater regionalization and protectionism, especially in strategically important sectors. In this context of global tension, especially between the US and China, European countries and the EU are working to define their place and role.

A determined move toward strategic autonomy² will define European regulatory output over the next few years. The EU

will issue and update regulatory frameworks that will set not only European but possibly also global standards. This will greatly impact the European investment environment, especially in the digital and environmental sectors, bringing both risks and opportunities. The European Commission has proposed the Digital Markets Act and Digital Services Act to regulate the digital sphere and big tech. And much work will be done to update the EU's legislative framework in order to enable the continent and its businesses to meet its emission reduction target of 55% by 2030. The single most important challenge will be to lead the way and transform while not compromising European competitiveness.

Globally, rivalries between big powers and the disentangling of US-China interdependence, as well as the geopolitics of technology and data, will result in trade tensions and tariff uncertainty. Within Europe, the lingering consequences of Brexit, a new German Chancellor after 16 years of Angela Merkel and, more generally, the political, economic and social consequences of the pandemic will determine the political risk environment.



Europe can't transform its economy and society alone. Whether it be raw materials to produce batteries or the skills to advance artificial intelligence, Europe will need access to global value chains. The key risk to Europe's attractiveness is that we try to do all this ourselves, that we look inward instead of outward.

Alessandro Cenderello
EY Managing Partner for EU Institutions

¹EY, *Geostrategy in Practice Survey*, May 2021.

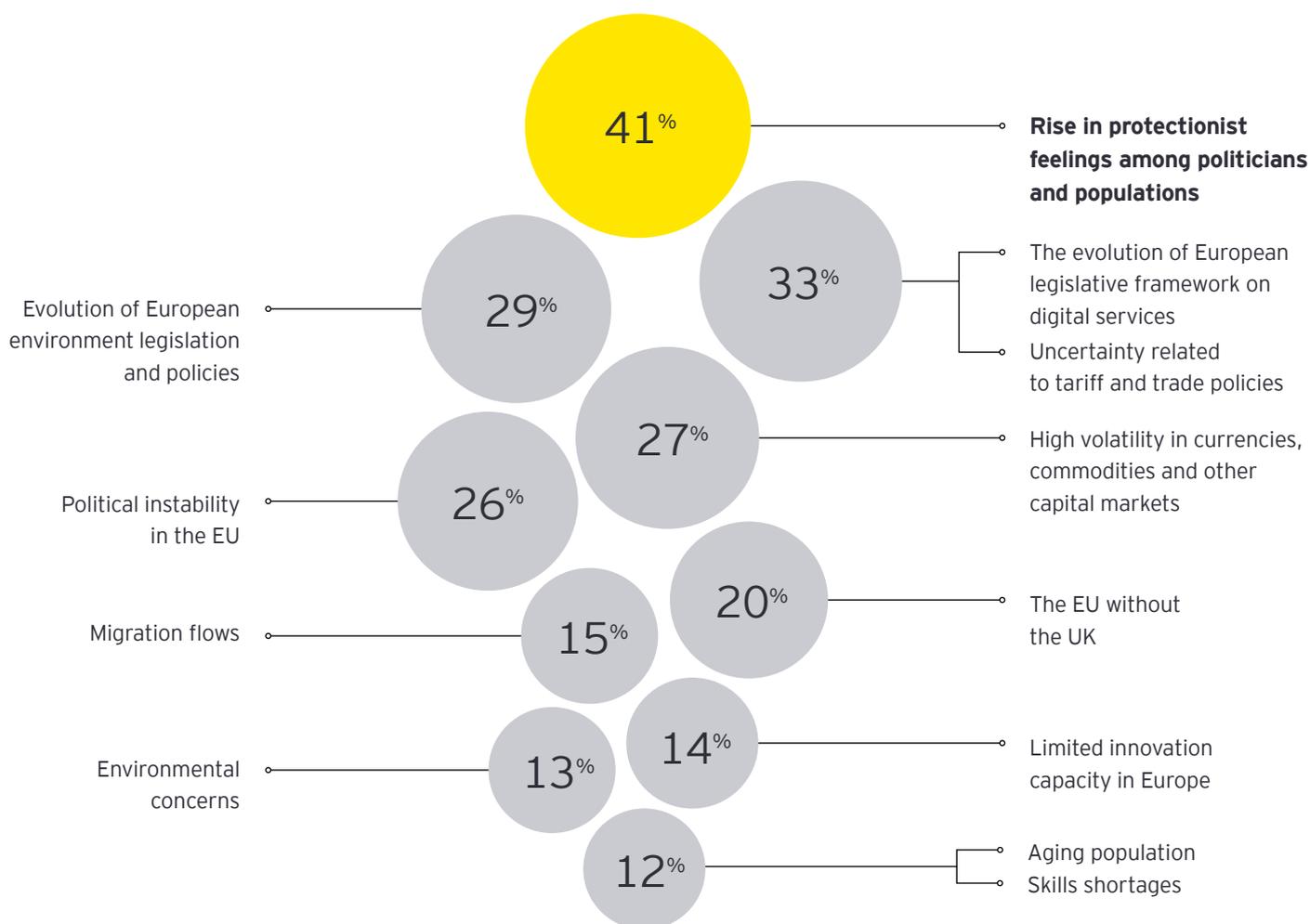
²EY, *2021 Geostrategic Outlook*, December 2020.

By introducing FDI screening, export controls and new competition laws, some governments have intervened in a way that even more directly impacts foreign investment in Europe. By international standards, the EU has adopted a

far less protectionist approach. In considering its next move, it must strike a careful balance between promoting foreign trade and investment and managing the risks that this brings.

Figure 6: Risks to Europe's attractiveness in the next three years

Q. What are the three main risks affecting Europe's attractiveness over the next three years? Select up to three options.



Source: EY Attractiveness Survey Europe June 2021 (total respondents: 550).



Life sciences and e-commerce: rare bright spots for investment

France, the UK and Germany are tied as Europe's top investment destinations

Manufacturing investment fell

22%

due to supply chain disruption and uncertain demand; e-commerce logistics and R&D investment both increased

Investment across all major sectors fell, with the exception of life sciences



2

A three-horse race between Europe's largest economies

Foreign investment fell in 8 of Europe's 10 largest FDI destinations. But some countries proved more resilient than others. A wide range of factors determine the attractiveness of individual countries, but in the year dominated by COVID-19, the countries that best weathered the pandemic and minimized economic losses also suffered the smallest declines in foreign investment.

For example, France, the UK and Spain saw their economies shrink by 8.2%, 9.9% and 11.0% respectively in 2020. All three countries experienced double-digit annual declines in foreign investment, with Spain experiencing the biggest drop (see Figure 7). By contrast, Germany's economy only shrunk by 4.9% and, in turn, only suffered a 4% decline in foreign investment. The result? Germany has caught up with France and the UK to the extent that the three are tied as Europe's top investment destinations.

Foreign investment increased in only 7 of Europe's 20 largest markets. Investment in these countries has historically been much lower than in France, the UK and Germany, meaning significant swings in investment levels are more likely. By contrast, investment was particularly weak in Hungary (-54%), Serbia (-32%), Spain (-27%), Romania (-27%) and Russia (-26%).

Figure 7: Number of foreign investment projects announced in Europe

Rank	Country	2019	2020	Change 2019/20	Market share (2020)
1	France	1,197	985	-18% ↓	18%
2	UK	1,109	975	-12% ↓	17%
3	Germany	971	930	-4% ↓	17%
4	Spain	486	354	-27% ↓	7%
5	Belgium	267	227	-15% ↓	4%
6	Poland	200	219	10% ↑	4%
7	Turkey	176	208	18% ↑	4%
8	Netherlands	255	193	-24% ↓	4%
9	Ireland	191	165	-14% ↓	3%
10	Portugal	158	154	-3% ↓	3%
11	Russia	191	141	-26% ↓	3%
12	Italy	108	113	5% ↑	2%
13	Finland	75	92	23% ↑	2%
14	Switzerland	73	91	25% ↑	2%
15	Austria	69	76	10% ↑	1%
16	Sweden	63	75	19% ↑	1%
17	Serbia	103	70	-32% ↓	1%
18	Romania	78	57	-27% ↓	1%
19	Lithuania	60	53	-12% ↓	1%
20	Hungary	105	48	-54% ↓	1%
	Other countries	477	352	-26% ↓	6%
	Total	6,412	5,578	-13% ↓	100%

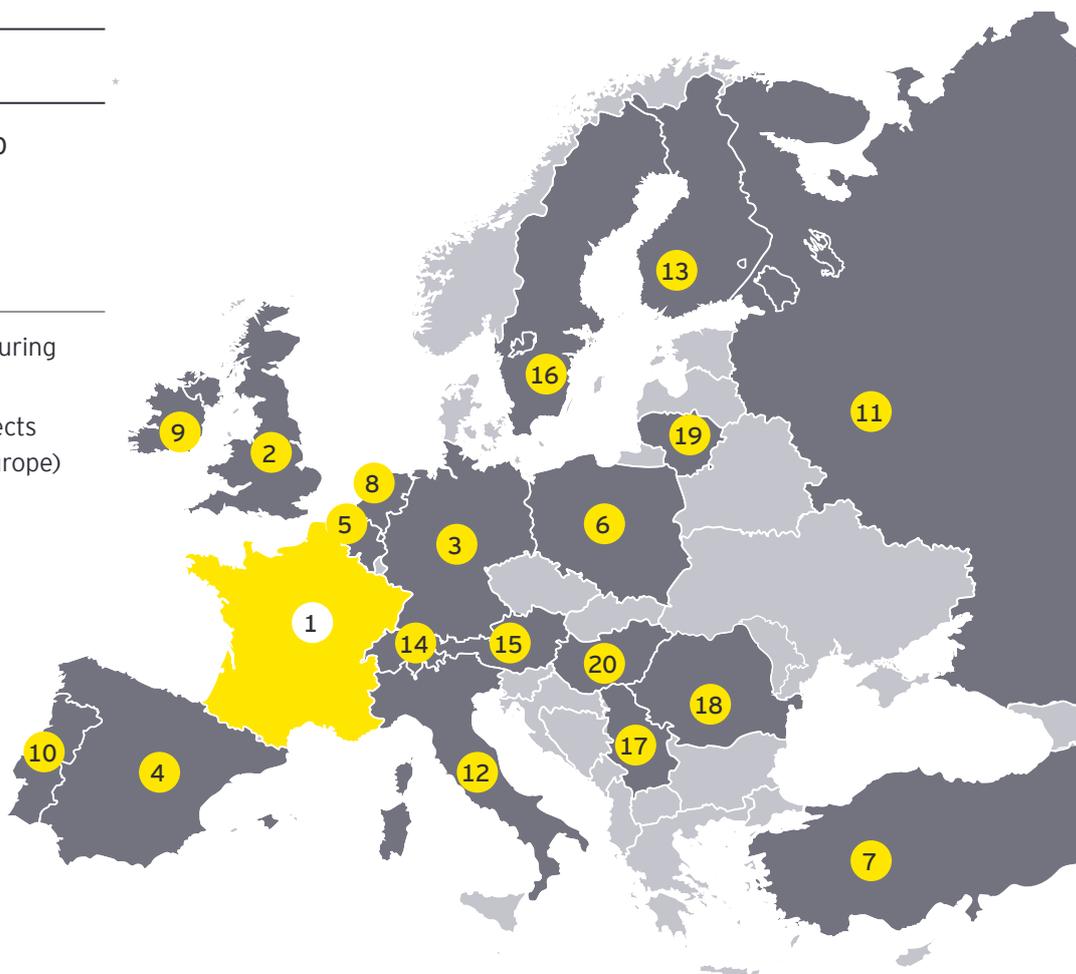
Source: EY European Investment Monitor (EIM) 2021.

#1 France

FDI projects Change 2019/20



- ▶ Top destination for manufacturing (341 projects)
- ▶ Top destination for R&D projects despite 23% drop (+4% for Europe)



Rank	Country	FDI projects	Change 2019/20	
#2	The UK	975	-12%	<ul style="list-style-type: none"> ▶ Top destination for headquarters (94 projects) ▶ Greater London region particularly affected, with a -29% drop (from 538 to 383)
#3	Germany	930	-4%	<ul style="list-style-type: none"> ▶ Top destination for data centers (34 projects) ▶ Top destination for business services (138 projects)
#4	Spain	354	-27%	<ul style="list-style-type: none"> ▶ 2nd largest destination for transport and logistics projects (40 projects) ▶ On average, each project creates 135 jobs (vs. 34 in France, 48 in Germany)
#5	Belgium	227	-15%	<ul style="list-style-type: none"> ▶ 3rd largest destination for transport and logistics (33 projects) ▶ The Flemish region is the fifth in Europe for R&D projects
#6	Poland	219	+10%	<ul style="list-style-type: none"> ▶ Top destination in Central and eastern Europe ▶ 6th largest destination for manufacturing (77 projects)
#7	Turkey	208	+18%	<ul style="list-style-type: none"> ▶ 2nd largest destination for manufacturing (153 projects) ▶ 2nd largest destination for projects in chemical, plastics and rubber (48 projects)

Rank	Country	FDI projects	Change 2019/20	
#8	Netherlands	193	-24%	<ul style="list-style-type: none"> ▶ 2nd biggest drop in terms of number of projects compared to 2019 in the top 10 ▶ 6th largest destination for software and IT services (50 projects)
#9	Ireland	165	-14%	<ul style="list-style-type: none"> ▶ 6th largest destination for software and IT services (50 projects) ▶ 6th largest destination for business services (40 projects)
#10	Portugal	154	-3%	<ul style="list-style-type: none"> ▶ 6th largest destination for software and IT services, which represents more than a third of the total number of projects (50 projects) ▶ Top activity: manufacturing (37 projects)
#11	Russia	141	-26%	<ul style="list-style-type: none"> ▶ Top sector: machinery and equipment (21 projects) ▶ Top activity: manufacturing (107 projects)
#12	Italy	113	+5%	<ul style="list-style-type: none"> ▶ Top sector: business services (15 projects) ▶ Lombardy is the leading Italian region with more than half of the projects (58 projects)
#13	Finland	92	+23%	<ul style="list-style-type: none"> ▶ Top sector: Software and IT services (15 projects) ▶ Top activity: manufacturing (22 projects)
#14	Switzerland	91	+25%	<ul style="list-style-type: none"> ▶ Top sector: Software and IT services (20 projects) ▶ Top activity: business services (40 projects)
#15	Austria	76	+10%	<ul style="list-style-type: none"> ▶ Top sector: Software and IT services (12 projects)
#16	Sweden	75	+19%	<ul style="list-style-type: none"> ▶ Top sector: Software and IT services (24 projects) ▶ Almost a third of the projects are related to business services (23 projects)
#17	Serbia	70	-32%	<ul style="list-style-type: none"> ▶ Top sector: Transportation, manufacturing and suppliers (21 projects) ▶ Top activity: manufacturing (56 projects)
#18	Romania	57	-27%	<ul style="list-style-type: none"> ▶ Top sector: Software and IT services (18 projects) ▶ Top activity: logistics (17 projects)
#19	Lithuania	53	-12%	<ul style="list-style-type: none"> ▶ Top sector: Software and IT services (23 projects) ▶ Top activity: Research and Development (19 projects)
#20	Hungary	48	-34%	<ul style="list-style-type: none"> ▶ Top sector: Machinery and Equipment (7 projects) ▶ Top activity: manufacturing (22 projects)

France: attracting most projects

France tops the foreign investment country rankings by 10 projects. Businesses announced 985 new investments in France, an 18% annual decrease. Investment declined significantly because key sectors such as aeronautics and hospitality were significantly disrupted by the pandemic; also, the number of projects announced in the previous year was uncharacteristically high. In 2019, investment rocketed by 17%, propelling France to attract more projects than any other European country for the first time. Still, labor and tax reforms in recent years, combined with its large market size, helped France to maintain its position as Europe's top investment destination.

Manufacturing investment fell in France by 17%. Despite this, the country maintains its European leadership in manufacturing, ahead of Turkey, accounting for 25% of all FDI manufacturing projects in Europe. Around 8 in 10 manufacturing projects in France involved existing investors expanding operations rather than investment in completely new projects.

UK: still facing Brexit uncertainty

Foreign investors announced 975 projects in the UK in 2020, a 12% annual decline. Despite the double-digit decrease, investment declined less severely than in France, leaving the two tied as the top destination for investment.

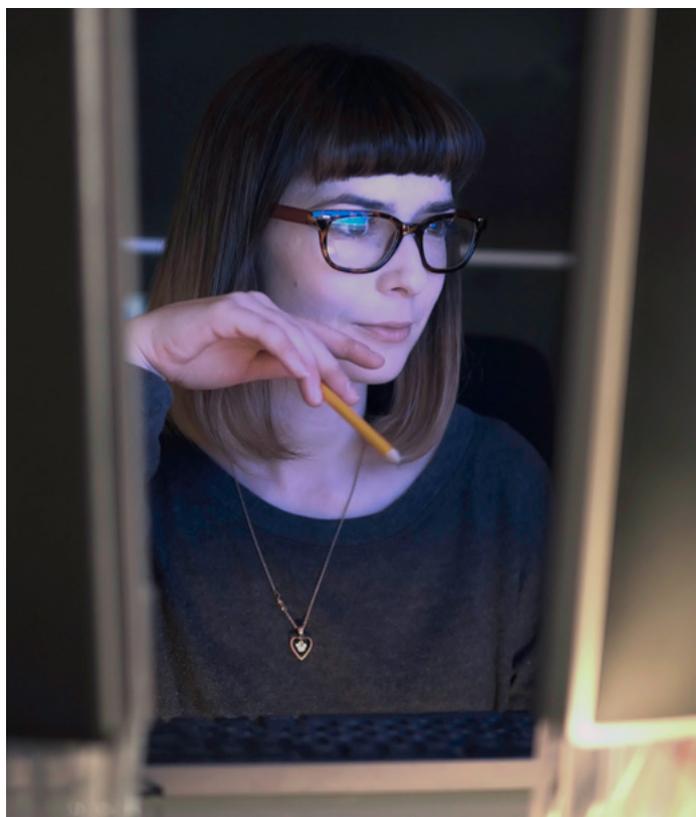
Amid ongoing Brexit uncertainty last year, just 112 manufacturing projects were announced in 2020, down 15% on 2019 and 20% on 2018. Although the long-term economic impact of the trade deal with the EU remains to be seen – and the manufacturing sector may suffer further – investors appear comforted that a deal was signed.

Foreign investment in the UK could have declined by an even greater extent had it not been for its dominance in service-based projects, which include business and shared services centers, regional headquarters, contact centers and R&D facilities. The UK attracted 21% of all service-based investment projects in Europe in 2020. It performed especially well in R&D, securing 114 such projects in 2020, a 12% and 54% increase on 2019 and 2018 respectively.

Germany: proving resilient

International businesses announced 930 FDI projects in Germany in 2020, a 4% annual decrease. Because Germany's pace of investment held up relatively well compared to that of both France and the UK, the country was able to narrow the gap with the two largest FDI destinations.

Investment proved resilient because Germany's good management of the pandemic in 2020 allowed it to cushion its impact on GDP, which only declined in Germany by half as much (-4.8%) as it did in the UK (-9.9%).³ In addition, exports remained strong, as Germany benefited from the early Chinese rebound. Looking at specific categories of FDI, the number of logistics projects more than doubled from 63 to 129 year on year. By contrast, the number of manufacturing projects decreased by 37% and 33% compared with 2019 and 2018 respectively.



³IMF World Economic Outlook, April 2021.

Manufacturing FDI suffers most, and reshoring help is not on the way

Not all FDI project categories are equal for the countries and cities that welcome them. Industrial projects (including manufacturing, logistics, and testing and services sites) are most highly sought after because they create significant numbers of qualified jobs and have a strong economic multiplier effect.

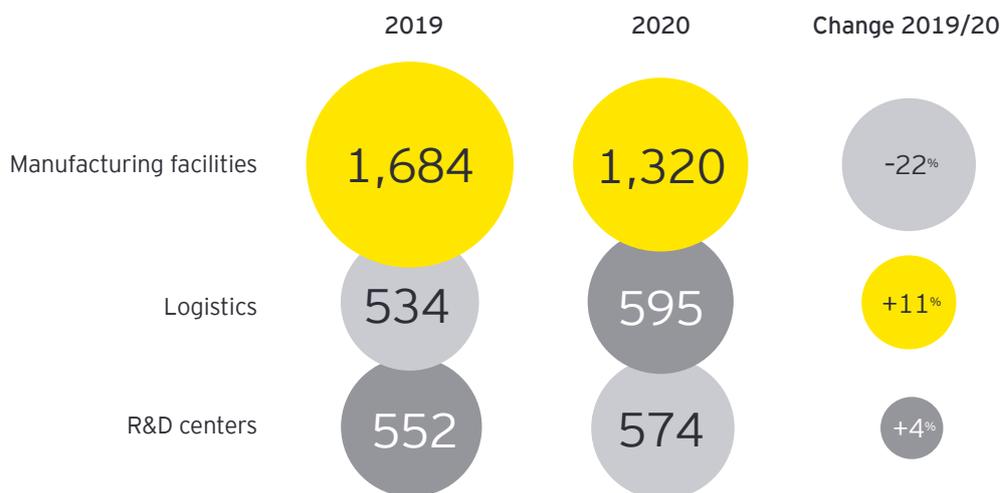
Just 1,320 manufacturing projects were announced in 2020, a 22% decrease on 2019 and a 33% decline on 2018 (see Figure 8). Manufacturing investment declined in all

major sectors, with the exception of life sciences, where the number of projects rose 50% annually to 105. However, despite the decline, there are reasons for optimism. Following a 12.8% contraction in 2020, industrial product manufacturing across the Eurozone is expected to grow by 9.6% in 2021 and 4.1% in 2022.⁴ This positive outlook may attract more manufacturing FDI in 2021 and beyond.

Logistics FDI increased but could not compensate for the decline in manufacturing investment: 595 projects were announced last year, an 11% annual increase. Notably, 80% of the increase was accounted for by Amazon, which doubled its number of logistics projects in Europe last year to cater for a spike in online shopping.

R&D FDI posted a minor increase: 574 R&D centers were announced in 2020, a 4% increase on 2019. Investment was particularly strong in the life sciences sector, where the number of R&D projects more than doubled to 75 projects.

Figure 8: Major foreign investment categories (drop in Europe)



Source: EY European Investment Monitor (EIM) 2021.

⁴Oxford Economics, March 2021.

Supply chain resilience prioritized over reshoring

Supply chain relocation could have a significant impact on FDI in Europe. When the pandemic first hit, severe supply chain disruption caused many businesses (83%) to consider nearshoring or reshoring back to their domestic market. This would have significantly impacted foreign investment in Europe, with international businesses potentially relocating operations away from Europe coupled with some European businesses returning to Europe. But one year later, the survey data reveals that most businesses have not pursued these plans, with just 20% planning to reshore operations to their domestic market and only 23% expecting to nearshore closer to customers (see Figure 9).

Currently, many companies would prefer to avoid disruptive and costly reorganizations. Asia is showing solid signs of recovery, and multinationals will maintain a presence there for now. Even so, some may relocate selected critical activities to Europe, mitigating future disruption risks, but it will take time and incentives to drive mass investments in Europe.

Although businesses are less keen to reshore and nearshore operations than they were 12 months ago, there is stronger appetite to reduce their dependence on single or dominant source countries and to operate more regional-based supply models.



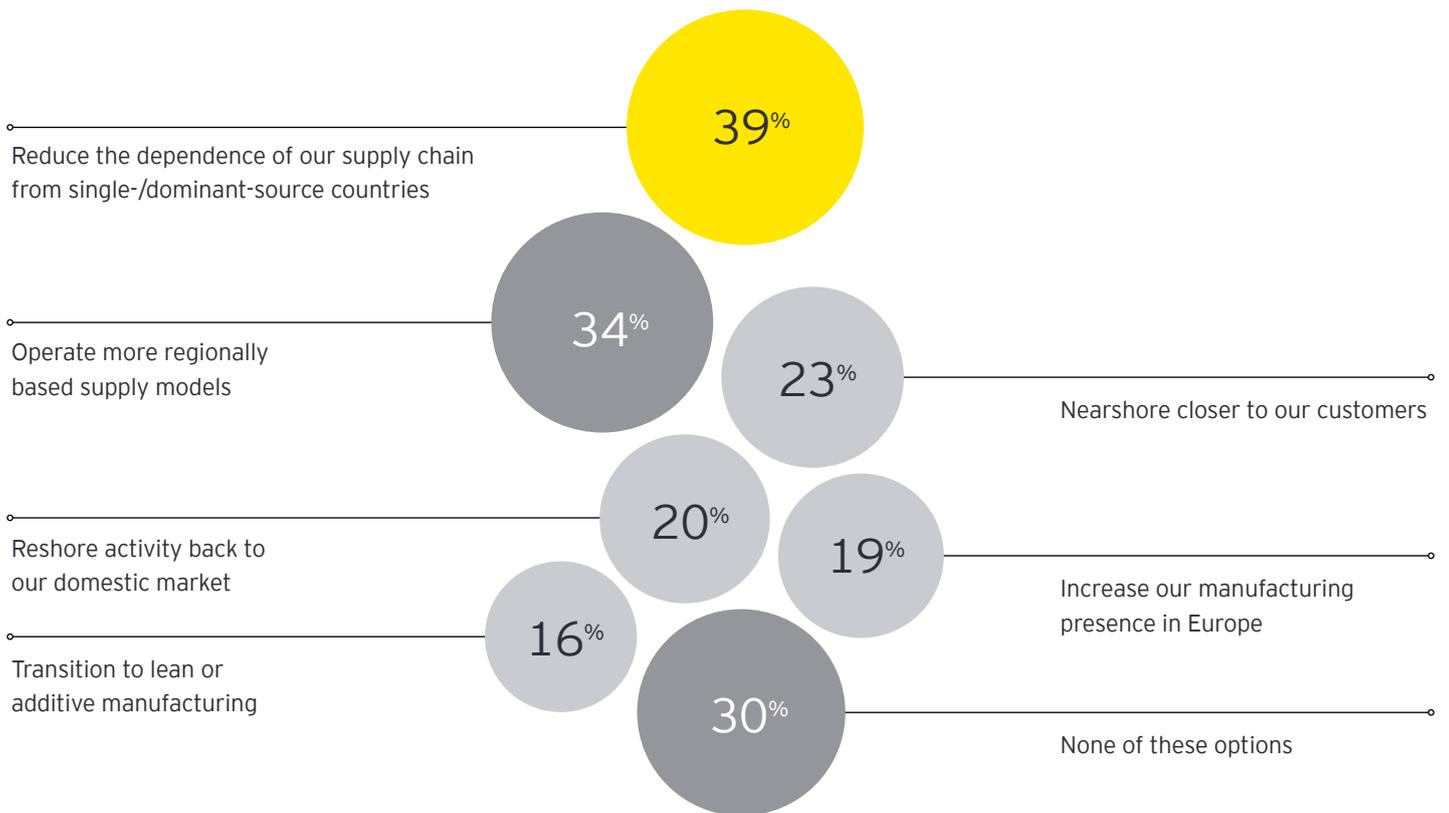
Both the pandemic and the escalating geo-political trade tensions mean that many advanced manufacturing and mobility businesses are looking at supply chain resilience as a key area of focus. In practice, this is likely to lead to more regional supply chains, with a corresponding likelihood of reinvestment in the supply chain moving to Europe.

Peter Matthews

EY UK&I Advanced Manufacturing & Mobility Leader

Figure 9: Limited appetite for major supply chain restructuring

Q. How will you change your supply chain model compared with what it was before COVID-19 ?



Source: EY Attractiveness Survey Europe June 2021 (total respondents: 550).

Sectors: a mixed bag of growth, resilience and distress

With the exception of life sciences, foreign investment fell in all major sectors in 2020 (see Figure 10). But some industries were hit much harder than others. Investment in the automotive and aeronautics industries declined by more than 30%, while investment in the machinery and equipment and finance sectors fell by more than 20%. By contrast, investment in the wholesale, retail and distribution, and chemicals sectors was more resilient, declining by just 2% and 5% respectively.

COVID-19 significantly influenced investment levels in each sector. The pandemic restricted the movement of people, so it's no surprise that investment fell in mobility-related industries. By complete contrast, the life sciences sector faced a surge in demand, which explains the 62% spike in projects.

Figure 10: The top 10 sectors for foreign investment in Europe (2020)

Sector	2019	2020	Change 2019/20	Market share (2020)
Software and IT services	1,219	1,046	-14% ↓	19%
Business services and professional services	774	691	-11% ↓	12%
Machinery and equipment	536	425	-21% ↓	8%
Agri-food	377	322	-15% ↓	6%
Transportation manufacturers and suppliers	472	305	-35% ↓	5%
Financial services	367	285	-22% ↓	5%
Chemicals, plastics and rubber	283	268	-5% ↓	5%
Life sciences	164	265	62% ↑	5%
Electronics	291	259	-11% ↓	5%
Wholesale, retail and distribution	246	240	-2% ↓	4%
Other	1,683	1,472	-13% ↓	26%

Source: EY European Investment Monitor (EIM) 2021.

The investment dynamics in notable sectors are outlined below:

- ▶ **Software and IT services** remains, by some distance, the largest sector attracting foreign investment in Europe. Businesses in this sector announced 1,046 projects in 2020, a 14% annual decrease. This accounts for 19% of all foreign investment projects in Europe. Investment in this sector was down significantly in the UK (-30%) and France (-29%), but increased in Germany (+13%). Despite the annual decrease in investment, the overall outlook remains bright. When asked which sectors will drive Europe's growth in the coming years, the digital sector was cited most frequently (see Figure 11).
- ▶ **Business and professional services** companies announced 691 projects in 2020, an 11% annual decrease. Accounting for 12% of all foreign investment projects in Europe, this is the second-largest sector for investment. Notably, businesses in this sector announced 23% fewer

projects in France in 2020 compared with 2019, meaning France has slipped below Germany as the largest attractor of business and professional services investment. Surveyed businesses are not bullish on the prospects for FDI in this sector, only ranking it sixth in terms of its potential to drive future growth. This is likely a result of companies in distressed sectors cutting outsourcing contracts, which can be done at relatively short notice.

- ▶ **Transportation manufacturing FDI** suffered the largest decline of all major sectors in Europe: just 305 projects were announced in 2020, a 35% decrease on 2019 and a 43% decrease on 2018. The limitations on movement during much of 2020 and into 2021 dampened investment levels significantly. Though investment in this sector fell in France (-27%), the UK (-23%) and Germany (-15%) in 2020, these countries still attracted around half of total foreign investment across the continent.



The trade dispute between the US and China could actually cement the US's dominance, with the country recently convincing TSMC and Samsung to invest in leading-edge manufacturing. The potential opportunity for Europe is that many companies are now reviewing their supply chain amid ongoing trade uncertainty. The challenge will be for European leaders to put in place incentives to encourage investment.

Tom Loozen

Partner and EY Global Telecommunications and EMEA TMT Leader



► **Financial services** companies announced 285 projects in 2020, a 22% yearly decline. Historically, the UK has secured the highest levels of FDI in financial services across Europe. Whilst the UK maintained its top position in 2020, the number of FDI projects fell to 56 (a 43% annual decrease) which places it just marginally ahead of France (49 projects) and Germany (37 projects).

► **Life sciences** FDI was robust in 2020. Businesses in this sector announced 265 projects, a 62% increase on 2019. The number of life sciences projects doubled in a number of countries, including France, Germany and Belgium, while the number surged by 62% in the UK. The increase was driven by businesses catering for surges in demand for the vaccines, treatments and PPE needed to combat COVID-19.

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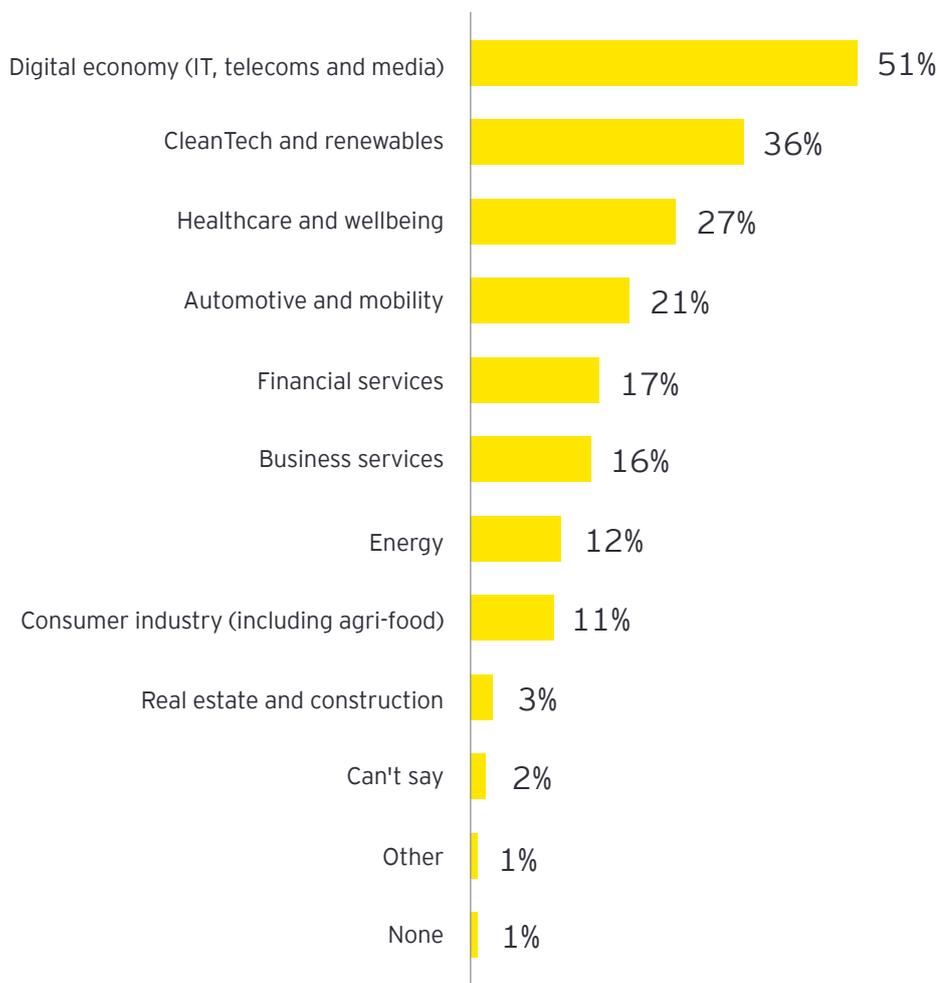
2020 was an incredibly challenging year for the financial services industry, but the pandemic also revealed a once-in-a-generation opportunity for transformation. CEOs across the sector believe that 2021 looks set to remain extremely challenging, but are more optimistic over the longer-term, with technology transformation helping the industry to better respond to evolving customer demands. The acceleration of digital transformation over the last year will continue apace. The pace of recovery is also very dependent on stronger consumer confidence and increased access to capital.

Zeynep Deldag
EY Netherlands Banking and capital markets leader



Figure 11: The digital economy, CleanTech and renewables will drive Europe’s future growth

Q. Which main business sectors will drive Europe's growth in the coming years?
Please select your top two options.



Source: EY Attractiveness Survey Europe June 2021 (total respondents: 550).

Skills, sustainability,
stimulus and simplification:
the key ingredients for
long-term attractiveness



The survey data paints an encouraging picture of Europe's long-term attractiveness. But policy-makers cannot become complacent. All regions, countries and cities vie for foreign investment, and the factors that businesses consider most important when determining where to invest are evolving. Take infrastructure as an example. Many years ago, transport infrastructure swayed investment decisions. Today, businesses consider digital infrastructure as a critical factor: three-quarters cite the rate of 5G rollout as important in determining which countries they invest in, and 25% say this is critically important.

This is just one example. The skills businesses need are rapidly shifting toward digital capabilities. Then there is the sustainability agenda, which is growing in significance and increasingly influencing location decisions. All of these trends were accelerated by COVID-19. For Europe, this means that it must not only continue to do the basics well, but also be agile enough to cater for businesses' new demands when considering investment destinations.

EY research shows that executives making location decisions expect three trends to accelerate in the next three years as a result of COVID-19 and therefore increasingly influence their European investment plans (see Figure 12):

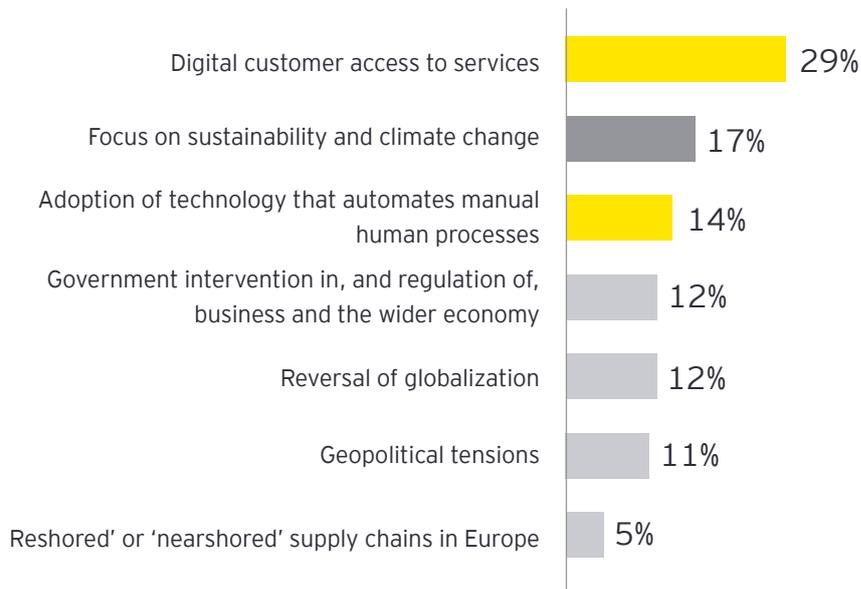
- ▶ The acceleration of technology for customer access, cost reduction and new work environments
- ▶ A sharper focus on climate change and sustainability in investment decisions, including social and societal concerns
- ▶ An expectation that multidimensional policies will play a role in economic recovery and encourage international investment

Knowing that these factors will increasingly influence investment decisions, EY professionals recommend that all three layers of government; European, national and local authorities adopt a four-pronged approach to bolstering Europe's long-term attractiveness:

- 1** Revamp Europe's digital capabilities
- 2** Cement Europe's sustainability supremo status
- 3** Implement multidimensional stimulus policies
- 4** Continue down the hard path of tax harmonization and transparency

Figure 12: COVID-19 will accelerate digital and sustainability megatrends

Q. Which of the following trends do you expect to accelerate most in the next three years as a result of COVID-19?



Source: EY Attractiveness Survey Europe June 2021 (total respondents: 550).



⁶Bruegel: [Setting Europe's economic recovery in motion: a first look at national plans](#), Bruegel

Revamp Europe's digital capabilities

COVID-19 has rapidly accelerated the adoption of technology by both businesses and consumers. When asked which trends they expect to accelerate most in the next three years as a result of COVID-19, businesses ranked digital customer access to services first and the adoption of technology that automates manual human processes third.

Technology-related factors have long influenced where businesses locate their operations, and COVID-19 has cemented this. But which issues are most important? According to the survey data, the availability of a workforce with technology skills is most important: 92% say this is either critical (43%) or important (49%).

Whether it be cloud computing, data analytics, remote sensors or artificial intelligence, the type of digital skills that businesses need depends very much on the type of business and the technologies it is developing and deploying. Given the rapid emergence of new technologies, even businesses themselves might not know which digital skills they will need 5 to 10 years from now. Therefore, rather than trying to evaluate how many, for example, artificial intelligence or sensor experts could be employed in a certain region, many businesses analyze which

universities create graduates with broader technology skills, and factor this into their location decisions.

European policy-makers understand the importance of digital upskilling and reskilling, and have made these crucial components of their COVID-19 economic recovery plans. The European Commission lists this as one of seven core focus areas for Member States, while some national stimulus plans for growth include a series of measures to enhance skills. Governments' focus on skills is admirable and should be welcome news for investors, given that it is the top factor that determines their location decisions. That said, it is imperative that governments engage with industry so that they harness the capabilities that industry will need in the future. European governments have not always done this as much as their counterparts in Asia and the US.

In addition, 20% of the national recovery programs under the EU Next Generation Recovery Fund need to be spent on digitalization projects. Italy has decided to spend €42b of its €204.5b national plan on digitalization (21%), Germany €15b out of €27.9b (54%), Spain €16b out of €69.5b (23%) and France €10b out of €41b (24%).⁵

Viewpoint

External viewpoint



Jovita Neliupšienė

Vice Minister, Ministry of the Economy
and Innovation of the Republic of Lithuania



We are striving for Lithuanian companies to reorient toward the creation of high value-added, digital and innovative industry; focusing on investments in the Lithuanian IT, communications and financial technology sectors and on attracting investment into manufacturing and life sciences.

Maintaining Lithuania's attractiveness

Lithuania is attractive to investors because of its talent. Many people have higher education, and we have a higher-than-average number of graduates per thousand people in the field of science, technology, engineering and mathematics (STEM).

But we want to do more. Therefore, the national Government, together with the OECD, has developed the Lithuanian skills strategy. This covers four priorities: developing the skills of young people; increasing the participation of adults and enterprises in training; using skills in the workplace; and strengthening the governance of the skills system. We have received about 60 recommendations on how to improve these areas and are now focused on implementing them.

Aside from skills, other initiatives we have put in place to improve our attractiveness include the creation of financial instruments for the development of infrastructure in Lithuania's regions, strengthening the innovation ecosystem, digitizing public services, and generally creating a more transparent and business-friendly environment.

Tax incentives are key to attracting particular investment

Tax incentives, competitive tax rates and various financing programs are crucial to attracting R&D and manufacturing companies. The initiative to exempt profits from large-scale investment projects for a

period of up to 20 years (the Green Corridor incentive) is particularly relevant – and unique to Lithuania. Within free economic zones, Lithuania also applies a corporate profit tax exemption to companies for 10 tax periods, and a 50% reduction for a further 6 periods thereafter.

In addition, R&D expenses are allowed to be deducted from taxable income three times in the tax period in which they are incurred. A reduction of taxable profit to 50% is also applied if the company invests in significant technological improvements.

Life sciences is primed for further growth

We are striving for Lithuanian companies to reorient toward the creation of high value-added, digital and innovative industry; focusing on investments in the Lithuanian IT, communications and financial technology sectors and on attracting investment into manufacturing and life sciences.

Over the last few years, the Lithuanian life sciences sector has grown tremendously and currently contributes 2% of Lithuania's GDP. The Government has an ambitious strategic goal for this sector of 5% of GDP by 2030.

Jovita Neliupšienė

Vice Minister, Ministry of the Economy and Innovation of the Republic of Lithuania

The new "phygital" workplace will require new tech skills and location strategies

Businesses' desire to locate their operations in locations where there is an abundance of workers with technology skills may seem surprising, given that many have now operated remote or distributed working for over a year and will likely continue to do so.

According to EY research, remote working will grow from 20% of employees being offered at least 20% of remote working time pre-COVID-19 to at least 60% of employees being allowed to work at least 40% of their time remotely.⁶ This raises an important question: if employees can productively work from home, why do businesses need to pay attention to the presence of talent as part of their location strategies?

There are, in fact, multiple reasons. For a start, businesses believe that the choice of quality locations will be crucial to attracting and retaining employees, even with increased remote working. In addition, many businesses want workers to be present in the office for at least some time in order to foster a collaborative working culture.

More than three-quarters of surveyed companies pinpoint the rate of digital adoption by the general population, IP rights protection, the regulatory approach to data, the availability of VC and other finance, as well as the rate of 5G rollout as important to determining where they locate. (see Figure 13).



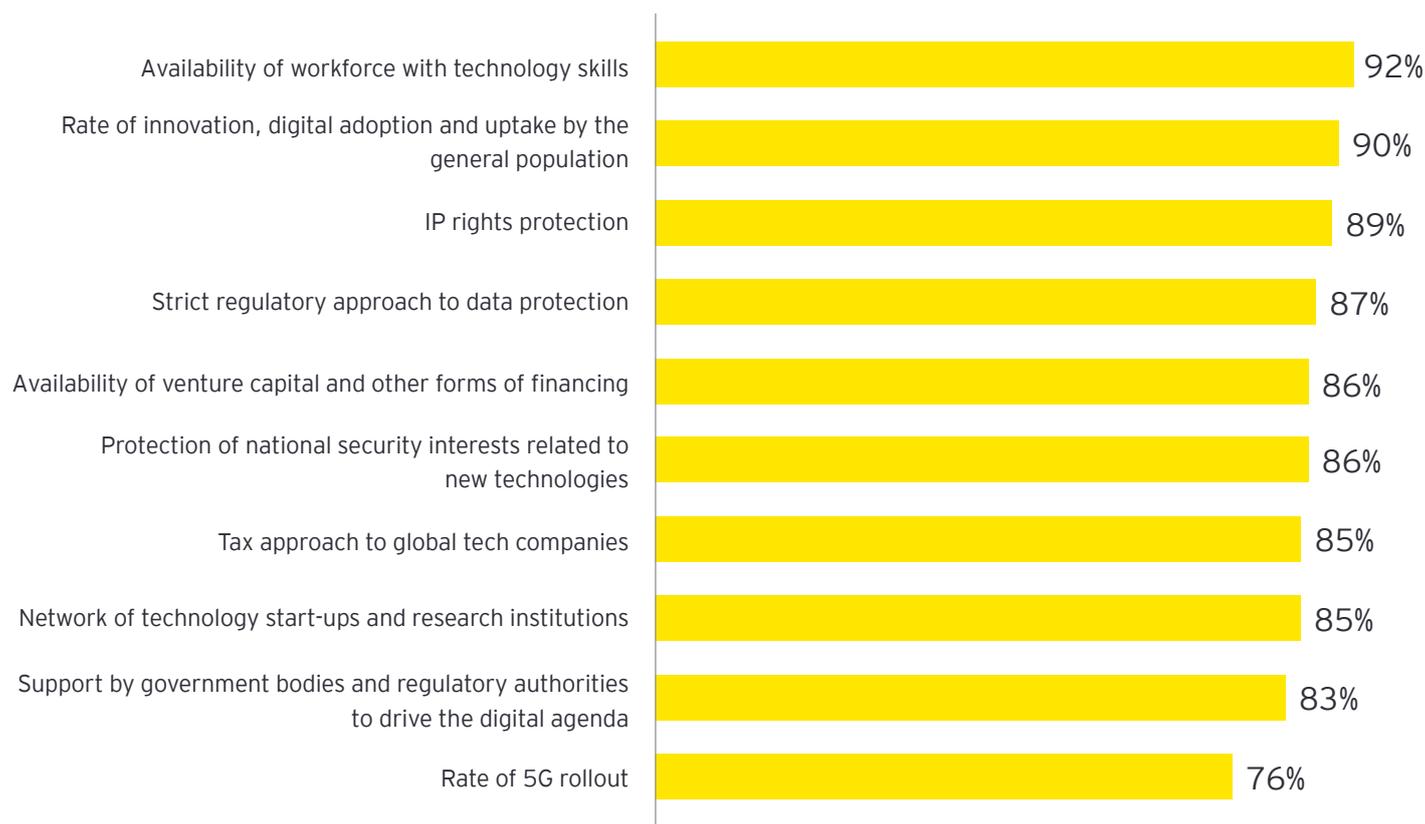
In our industry, 5G, edge cloud, network function virtualization and network APIs unlock exciting new business models. Network functions become available 'as a service' – capacity, speed, latency, quality of service – dynamically, locally and on demand. Already today we provide commercial enterprise mobile networks for critical and highly sensitive environments, such as in mining.

Rainer Deutschmann
Group Chief Operating Officer, Telia

⁶EY and Urban Land Institute, [Future of Work: a global real estate player's point of view on the Future of Work and its impact on real estate](#), 2020.

Figure 13: Availability of a workforce with technology skills is top of the agenda

Q. How important are the following technology-related factors in determining which countries you invest in across Europe? Answers = "critical" or "important."



Source: EY Attractiveness Survey Europe June 2021 (total respondents: 550).

Viewpoint

External viewpoint



Kali Durgampudi

Chief Technology Officer in the health care
information technology industry, US

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The growth rate of technology graduates is also important in addition to the absolute number. For example, one city we're evaluating had roughly 20,000 technology graduates five years ago compared with 50,000 today, so there's clearly an upward trajectory, which we like.

Tapping into talent in the age of COVID-19

As any growth organization, we have evaluated several strategic workforce planning options, including locations around the country and beyond, that will allow us to meet our annual growth targets. The most important factor when thinking about any potential locations is the availability of talent.

When we started evaluating locations, we were primarily interested in typical R&D and shared services roles, such as claims analysts and financial analysts. But since then, we have realized that skills in artificial intelligence, natural language processing and robotic process automation will also be vital. We need a location that will provide us with the skills we will need in the next decade, not just for right now.

Because it's hard to assess which skills we might need in 10 to 20 years time, we assess potential locations based on the number of technology universities and training centers that adapt to the needs of the market. We look at universities' ability to pivot into new courses. New courses and training centers are always popping up in Asia as new technology emerges, and this is slowly starting to happen in Europe.

The growth rate of technology graduates is also important in addition to the absolute number. For example, one city we're evaluating had roughly 20,000 technology graduates five years ago compared with 50,000 today, so there's clearly an upward trajectory, which we like.

Importantly, we are not just looking at where there are deep pools of talent, but also locations where, culturally, there is less attrition. It's certainly the case that in some locations, workers are culturally more predisposed to switch jobs more frequently. Competition is also an important factor: we don't want to be located in an area where we end up competing with the likes of Amazon or Google for top talent.

Although Europe is catching up, there are, generally speaking, deeper pools of digital talent in Asia. But there's less attrition in Europe, which somewhat compensates for this. We are always looking for this decade's growth location rather than the past one's.

Kali Durgampudi

Chief Technology Officer in the health care information technology industry, US

Cement Europe's sustainability supremo status

Sustainability increasingly influences location decisions

The imperative to decarbonize and improve environmental sustainability is increasingly impacting foreign investment in Europe: 9 in 10 surveyed businesses say environmental sustainability is important to their investment strategy, and 24% say it is critical (see figure 14). Encouragingly for Europe, 85% believe Europe is a green leader and, of these, 85% say this positively influences their investment decisions. This trend is here to stay, and will likely accelerate further as climate policy and regulation gains momentum. When asked which trends they expect to accelerate most as a result of COVID-19, businesses rank a focus on sustainability and climate change second behind only digital customer access to services.

Why is sustainability important? Whether it be from customers, employees or investors, or direct regulatory requirements, businesses across most sectors are being put under pressure by multiple stakeholders to act more sustainably. Many businesses have taken notice and now consider environmental sustainability when evaluating key business decisions, including where they locate their operations. This might include the percentage of renewables in the energy mix in certain countries, recycling provisions, the coverage of public transport (so that employees do not need to drive to work) and much more.

Of course, although Europe's global "green leadership" creates unprecedented opportunities for investment, it also brings the challenge of maintaining a level playing field for doing business in Europe.



Europe's ambitious plans to be carbon neutral by 2050 and to reduce greenhouse gas emissions by 55% by 2030 creates a huge amount of foreign investment opportunities. Of course, we're seeing new wind and solar manufacturing and assembly facilities. But we're also seeing projects in new green sectors, including bio-based materials for green buildings, green hydrogen for industry and batteries for electric vehicles.

Alexis Gazzo

EY & Associés Climate Change Leader

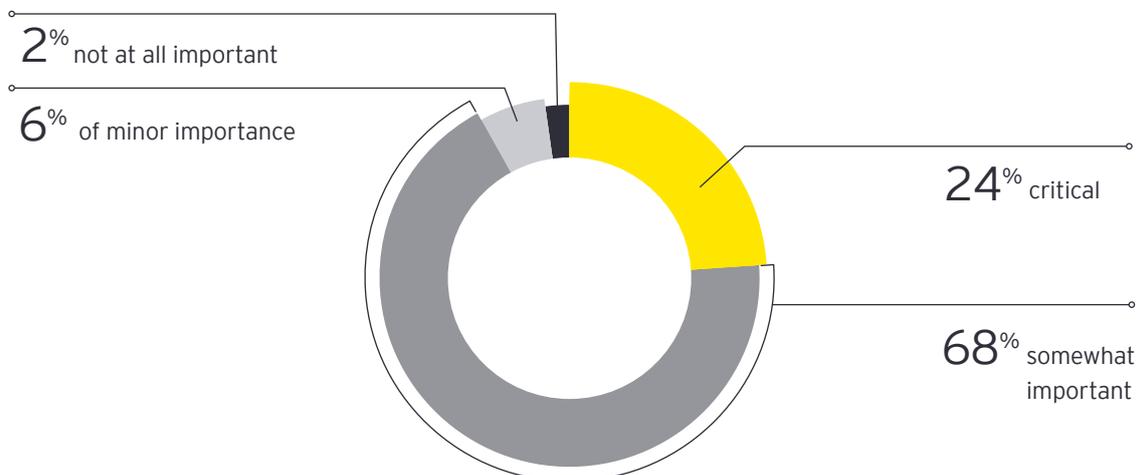
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Companies that do not embed sustainability in their business strategies and leave it for headquarters to execute, or treat it as an anecdote in their annual reports, are going to have ‘Kodak moments,’ which means that they will disappear. The chemicals industry, specifically in Europe, is more known as the polluter, the CO2 emitter, rather than the solution provider. It needs to reimagine itself, and the EU's Green Deal presents a huge opportunity for our industry and others to work on this green rebound.

Ilham Kadri
CEO, Solvay

Figure 14: The importance of sustainability to investment strategies

Q. How important is environmental sustainability to your investment strategy?



Source: EY Attractiveness Survey Europe June 2021 (total respondents: 550).

The green opportunity

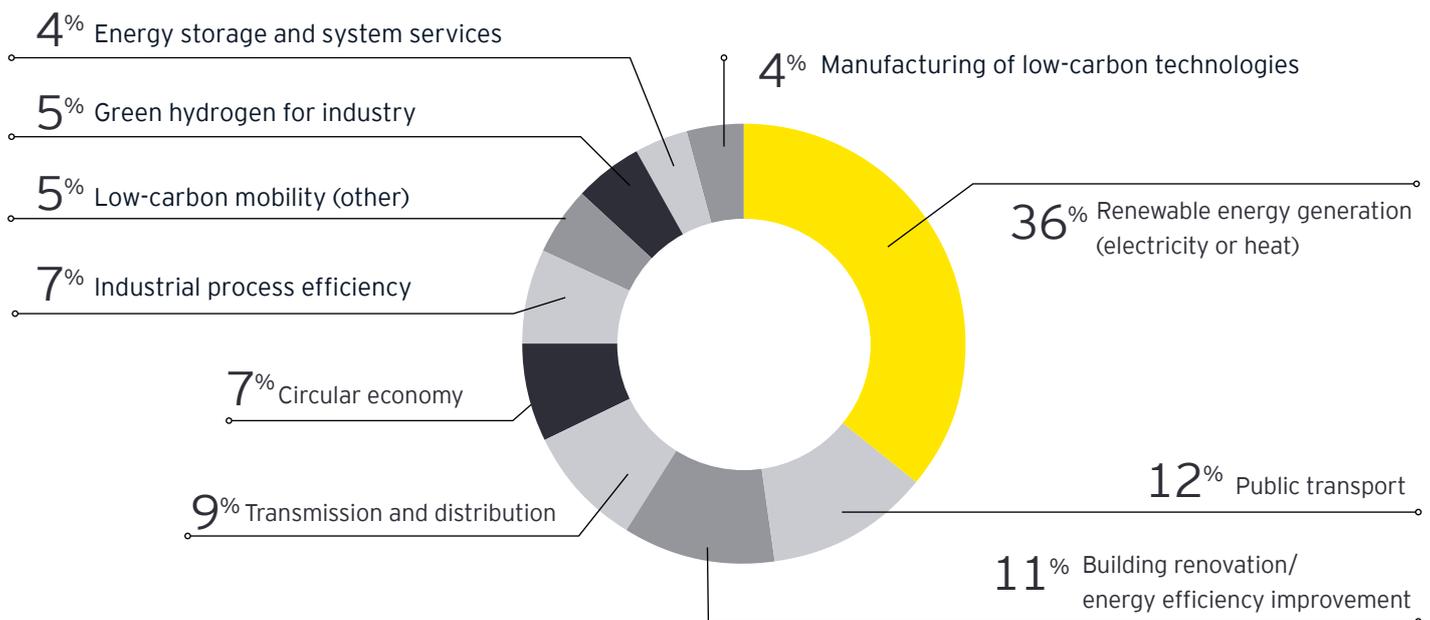
Europe’s sustainability drive also impacts foreign investment because it is spawning new green industries, many of which require foreign investment. These include wind turbine manufacturing facilities, solar module assembly sites, and even newer sub-sectors such as hydrogen batteries. Surveyed businesses believe that CleanTech and renewables is the sector with the second-highest potential to drive Europe’s growth in the coming years, behind the digital economy (see Figure 11).

But a key question remains: does the green economy have enough potential to create jobs at the scale needed to support a genuine recovery in Europe? According to EY analysis, the answer is unequivocally “yes.” The EY organization has identified 1,000 shovel-ready green projects that could reach financial close within the next 24 months, with the potential to

create significant social, environmental and economic value. They require €200b of public and private investment but, due to the fact that these projects have a higher job-intensity ratio than those in traditional sectors, could create almost three million jobs. This is equivalent to nearly a quarter of the jobs lost in Europe due to COVID-19. Renewable energy generation infrastructure accounts for 36% of these projects, but there are also opportunities in transport, buildings, industry and land use (see Figure 15).

This is only the beginning. These 1,000 shovel-ready projects account for just 10% of the total number of green projects in the development pipeline in Europe. This means that the entire pipeline of green projects could create more than the 12 million jobs lost in Europe due to COVID-19.

Figure 15. Shovel-ready green projects in Europe (segmented by sector)



©EY, Perspectives on a European green recovery from the COVID-19 pandemic, 2021.



The fourth industrial revolution used to be about using technology to be more productive. But now, the emphasis has switched to using technology to minimize your business' impact on the environment.

Sandeep Mishra

Director, EMEIA Markets, EY

Enter long-term value

Beyond environmental sustainability, businesses also face pressure to address other societal problems, from income inequality to the ethical challenges associated with new technologies such as artificial intelligence. By addressing these challenges and therefore generating benefits for a wide range of stakeholders, including employees, customers and wider society, business can generate long-term value.

COVID-19 has intensified the importance of long-term value: 66% of business leaders say that it increased expectations from stakeholders that their company will drive societal impact, environmental sustainability and inclusive growth. In parallel, more than three-quarters say that a focus on sustainable and inclusive growth has been critical to building trust with stakeholders in uncertain times, while 79% believe that companies with a focus on long-term value will emerge stronger in a post-pandemic world.⁸

Quite how the imperative to deliver long-term value will influence location decisions varies considerably depending on the individual business. For example, manufacturing businesses considering the location of their supply chains may increasingly shun regions with a poor record on human rights or huge income inequality. Alternatively, technology companies may begin to favor locations where there is strong dialog between government and businesses on how to address the ethical challenges associated with technologies such as artificial intelligence.

What does this mean for public authorities tasked with attracting foreign investment? In addition to getting the basics right, they will also have to demonstrate how their locations align with businesses' growing desire to create sustainable, long-term value for their employees, investors, customers and wider society.



Future investors will increasingly focus on companies' environmental sustainability and wider social impact. Based on BlackRock's recent analysis, companies with better ESG profiles in the automotive, banking and energy industries outperformed their peers; and anecdotal evidence suggests biopharma and MedTech companies are receiving better terms on debt because of their sustainability compliance.

Pamela Spence

Partner, Global Health Sciences and Wellness Industry Leader, EY

⁸EY, Will there be a 'next' if corporate governance is focused on the 'now'?, 2021.

Implement multidimensional stimulus policies

Europe's RRF is the EU's COVID-19 recovery package. It will provide €672.5b in loans (€360b) and grants (€312.5b) to help EU Member States recover sustainably. In making this capital available, the EU has adopted a radically different approach from its global financial crisis recovery plan, which prioritized fiscal prudence over expansionary investment.

As the RRF is closely aligned with the European Commission's priorities, the funds must be used to drive a sustainable and inclusive recovery that promotes green and digital transitions. More specifically, the EU intends for the funds to be used to promote clean technology and renewable energy, energy-efficient buildings, sustainable transport, rapid broadband, digitalized public administration, cloud capabilities and digital upskilling.

Recovery programs will boost long-term attractiveness, but shorter-term stimulus is also required

Will the European and national recovery plans significantly influence investor decision-making? An initial review of the survey responses would indicate not. Foreign investors say that the weight of national stimulus packages and their potential impact is not a critical factor in determining where they invest (see Figure 16).

This is likely because most European Member States had not announced their stimulus packages when the survey data was collected, which may have led investors to downplay their importance. Investors also likely noted that national and European stimulus packages are aimed at the deep transformation of economies and societies – a comprehensive reboot structured around digital and environmental priorities – at a time when companies express an urgent need to reopen and effectively reignite their markets and operations.

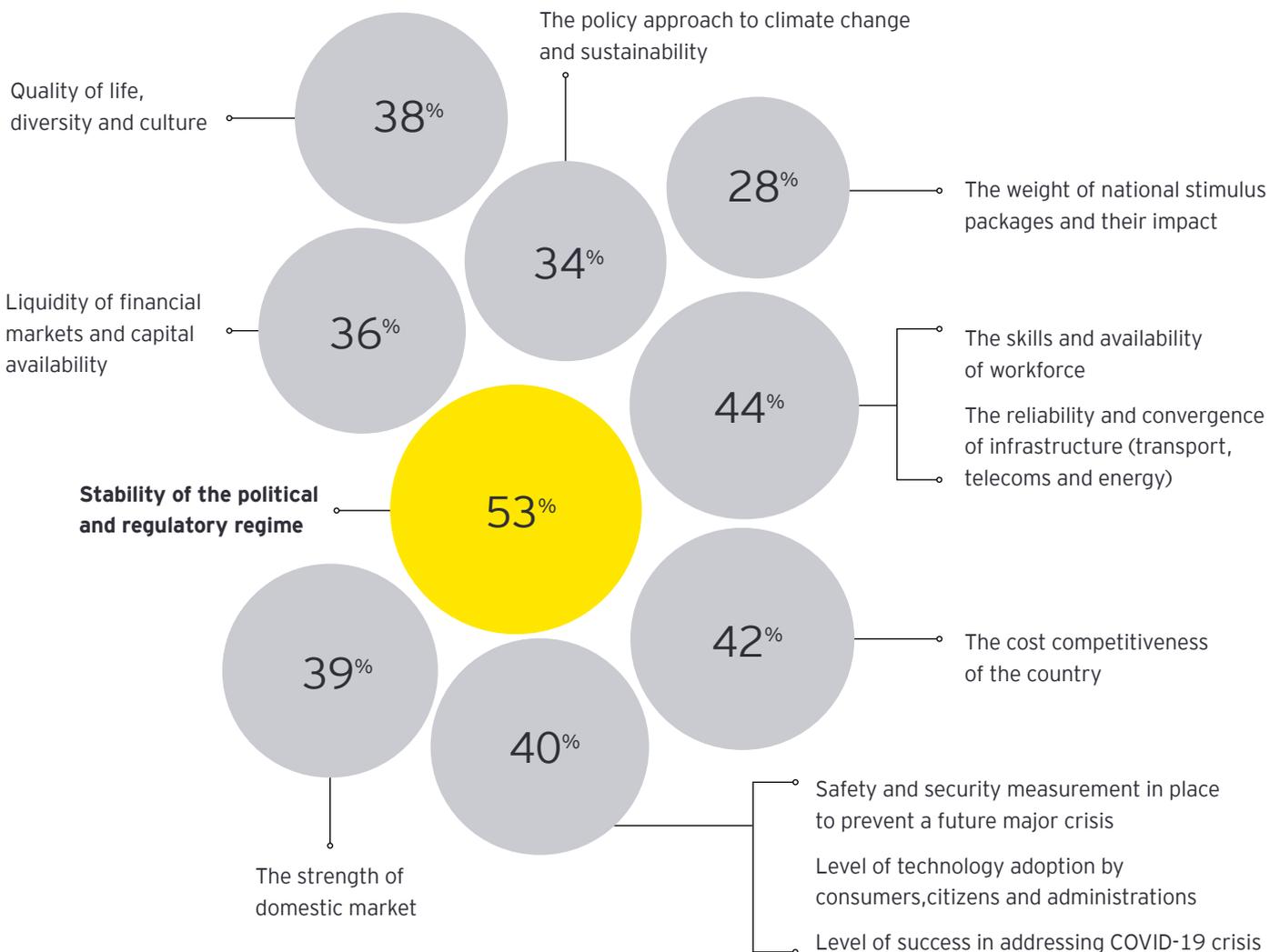
But although individual investors may not appreciate its importance, the RRF will certainly boost Europe's attractiveness in the long-term. There will likely be some foreign investment opportunities associated with large-scale infrastructure projects, but perhaps more importantly, a significant proportion of the funds will be allocated to drive reforms, which will undoubtedly fortify Europe's attractiveness in the long-term.

In addition, by specifically promoting Europe's sustainability and digital transformation (at least 37% of expenditure must be allocated to climate investments and reforms and 20% must be used to foster digital transformation), the RRF is addressing two of the most important areas for businesses when considering investment decisions. It therefore has great potential to boost Europe's long-term attractiveness.

⁹Bruegel, [Setting Europe's economic recovery in motion: a first look at national plans](#), 2021.

Figure 16: Political stability, reliable infrastructure and skills sway investors

Q. In your company's future location choices, what factors may influence your decision to select a particular country? (Select all that apply)



Source: EY Attractiveness Survey Europe June 2021 (total respondents: 550).

National recovery plans can make a difference but must not be a burden

Interestingly, the initial plans submitted by Europe's largest economies show that countries intend to adopt radically different approaches to allocating this money. Germany, for example, plans to invest half of the funds it receives from the EU in digitalization, while Spain, Italy and France will allocate less than a quarter to this area. In addition, France will allocate around half of its funds to green initiatives, whereas the other three countries will invest around 40%.⁹ Smaller countries also have different priorities. By way of example, Greece will spend more than half of its total allocation on green energy and digitalization projects, including 5G networks and electric vehicle infrastructure.

Although it is too early to tell which domestic recovery plans will best help their respective economies, it is obvious that investors have taken note of their priorities. In late April, countries began presenting their recovery and resilience plans to the European Commission. As much as companies applaud the opportunities that these plans create, they often complain about the additional administrative burden and regulation

that accompanies them. This might also explain, in part, the UK's strong attractiveness. The UK, France and Germany are ranked as the three countries with the most credible plans and, to some extent, this drives their attractiveness. While countries take different approaches to managing the pandemic, balancing the need to save health systems against economic recovery requirements, collective European efforts have been a welcome addition to national strategies and helped in reassuring foreign investors.

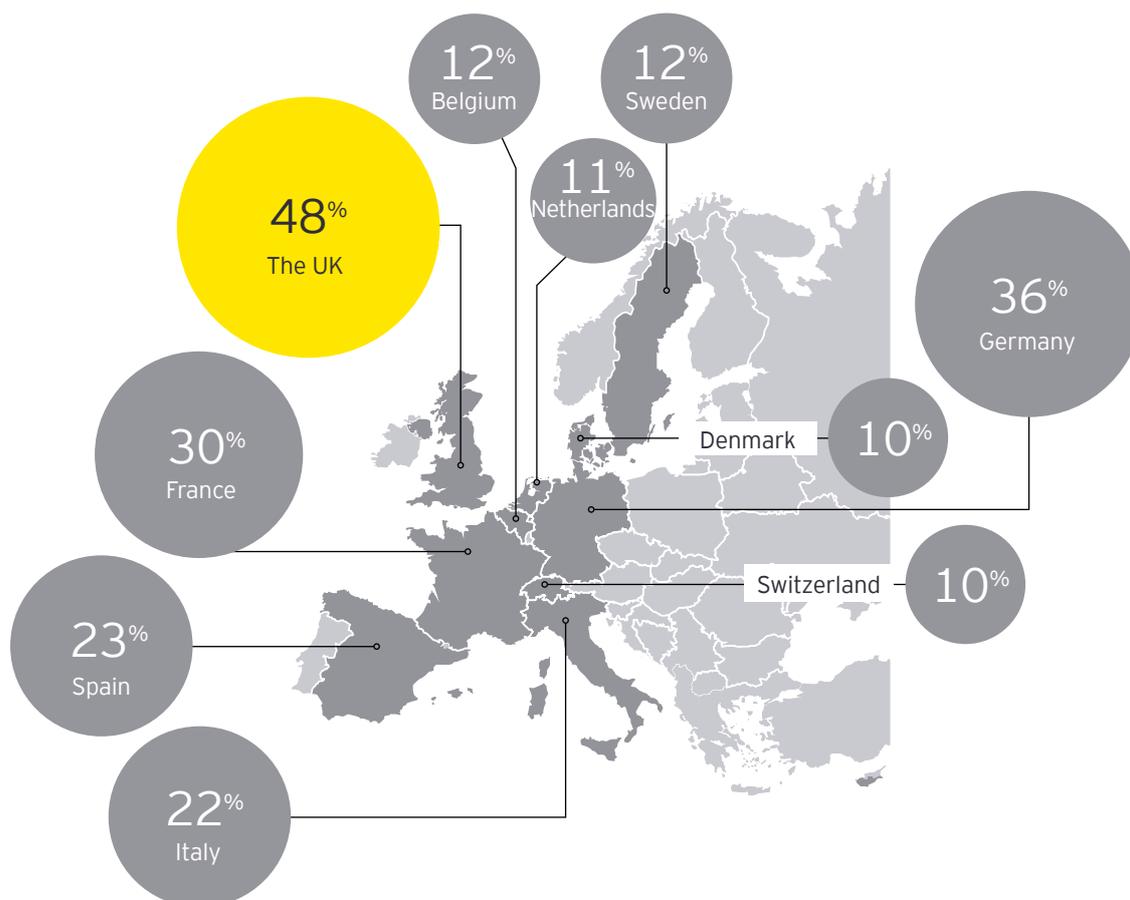
Although many details remain unknown, investors may also be excited by the UK's 'Build Back Better' recovery plan, which will target significant investment in infrastructure, skills and innovation. When asked which European countries have the most credible and investment-friendly COVID-19 recovery plans, the UK ranks first, ahead of Germany and then France (see Figure 17).

The UK's rising allure is also in part driven by its proactive stance in engaging with foreign investors following the agreement of a trade deal between the UK and the EU right at the end of 2020.



Figure 17: The UK has the most credible and investment-friendly COVID-19 recovery plan

Q. Which European countries do you believe have the most credible and investment-friendly COVID-19 recovery plans? Please select your top three choices.



Source: EY Attractiveness Survey Europe June 2021 (total respondents: 550).

Viewpoint

External viewpoint



Guillaume Alvarez

Senior Vice President, EMEA, Steelcase, and
Chairman of the European Executive Council

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I think there's an opportunity across Europe to bring some real growth and development into secondary cities and smaller communities. One of the things that I think will stick from COVID-19 is people's increased willingness to work from home or secondary workplaces, and live away from big cities.

New thinking is required to unlock Europe's full potential

In some ways, geopolitical events have had a much longer-lasting impact on our location choices and investment strategies in the past 12 months than COVID-19. Take Brexit, for instance: we have many clients in the UK, so it actually caused us to invest in the country and create more jobs there because we needed to have a local supply chain. We didn't want to be exposed to any supply chain or people movement risks. There is so much noise about Brexit, but when you look beyond all of the negativity, there's actually some good things happening with the UK economy.

European stimulus: well-meaning but slow

Businesses welcome the stimulus packages because they will help companies, communities and individuals. There was some great help from individual European countries, but everything at the European level is very slow. Our US business has already received support, but we'll have to wait until the second half of the year for anything in Europe.

That said, initiatives such as the Green Deal could be a real opportunity. But there's also concern that it might bring more regulation and constraints to doing business.

Unleashing all of Europe's potential

I think there's an opportunity across Europe to bring some real growth and development into secondary cities and smaller communities. One of the things that I think will stick from COVID-19 is people's increased willingness to work from home or secondary workplaces, and live away from big cities.

But business owners and governments need to think differently about leadership, the workplace and the infrastructure of cities and small towns for this to happen. And that includes physical and digital infrastructure, because access to high-speed internet is essential. Work, workers and workplaces are all evolving, and we need a growth mindset in the EU institutions to capture the full potential of these opportunities.

Guillaume Alvarez

Senior Vice President, EMEA, Steelcase, and
Chairman of the European Executive Council

Continue down the hard path of tax harmonization and transparency

Tax battle lines are shifting

Based on our experience of working with clients, tax has fallen down the agenda in recent years as a factor that determines where businesses locate their operations in Europe. We think this is in part thanks to the work of the EU and other multilateral organizations such as the The Organization for Economic Co-operation and Development (OECD) in driving tax harmonization. Sure, there may still be some observable differences in corporate tax rates across Europe. We believe that tax incentive schemes will become less of a factor due to the work of the EU Code of Conduct Group – which assesses whether potentially preferential tax regimes harm competition – and the enforcement of State aid regulations. President Biden’s objective for countries to adopt a global minimum rate of corporation tax would, if implemented, further harmonize tax regimes, not just in Europe but globally.

Although more uniform corporate tax rates would be a blow to the attractiveness of some historically low-tax countries, it may boost the attractiveness of traditionally high-corporate tax nations such as Germany and France. Europe’s overall

attractiveness may also increase if harmonization creates a more simplified and transparent corporate tax regime across the continent.

Uniform tax rates won’t necessarily eradicate tax as a factor that determines countries’ attractiveness. Instead, countries may look at other ways of remaining competitive, such as the rates of indirect taxes or the extent to which new types of tax, such as environmental taxes, are implemented. Countries may also try to carve out a competitive edge by how they administer taxes and the extent to which they assist large businesses with tax compliance.

Governments may be unwilling or unable to lower indirect taxes or relax administration. The US\$30t in financial stimulus provided by governments around the world will have to be paid for somehow. According to a report from EY tax professionals in 68 jurisdictions, increased enforcement of existing taxes and shifting resources from other government priorities are the most likely ways that governments will cover the cost of this stimulus.¹⁰



¹⁰EY, How tax will play a role as the world strives for stability in 2021, 2021.

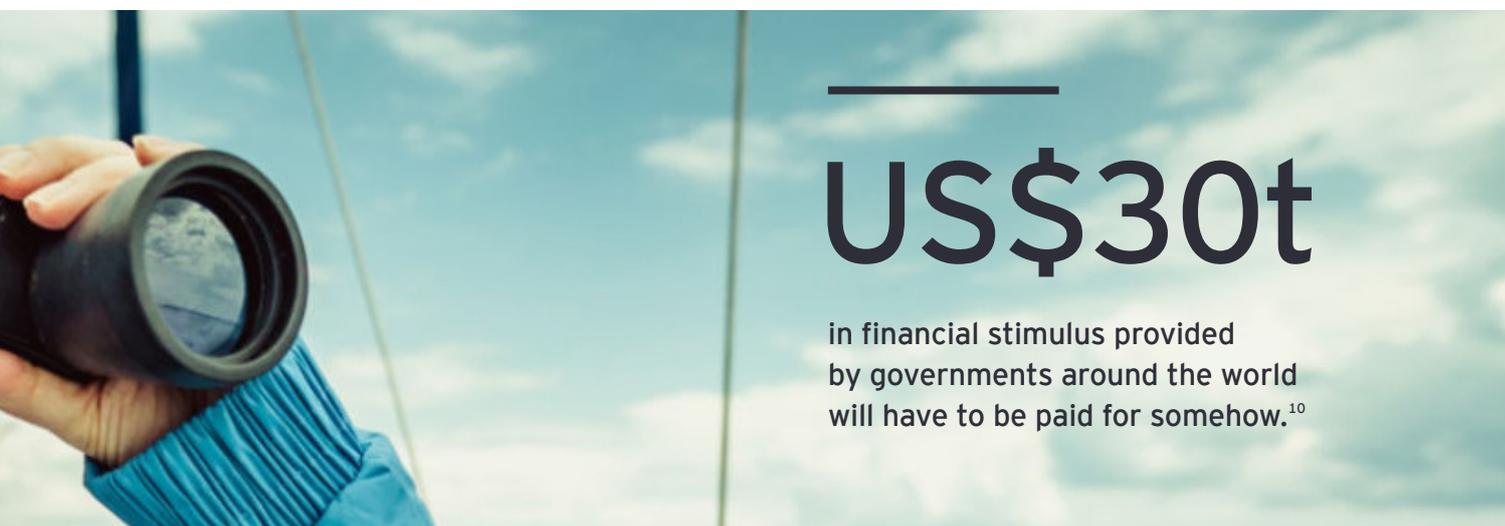
National digital taxes create complexity

Digital taxes are also currently in the spotlight, with the OECD leading global efforts to create new rules for taxing digital businesses. It has set itself a target of reaching consensus among the 139 participating countries by mid-2021. It has two overarching objectives. The first is to ensure companies pay taxes where they conduct sustained and significant business, and the second is to agree a global minimum tax rate to reduce competition.

In the meantime, a few countries have implemented their own digital taxes. This has created immense cost and complexity in ensuring compliance, because it has given rise to a variety of VAT, customs duties, levies and other hybrid digital transaction

taxes. It's therefore vital that the EU maintains its efforts as part of the OECD's program to reach consensus on how to tax digital businesses.

Even if the OECD does not reach consensus, pressures from individual countries will result in digital businesses having to pay more tax in the jurisdiction of consumption. What does this mean for foreign investment in Europe? It's very difficult to say, as the picture is so complex. But one potential consequence is that US digital companies may throttle back on establishing a presence in current low-tax jurisdictions in Europe if they can no longer enjoy the tax benefits. Given that the US is the largest investor in Europe, accounting for 21% of all announced projects in 2020, any decrease in US appetite could have a significant impact on overall investment levels.



Viewpoint

EY viewpoint



Jean-Pierre Lieb

EY EMEIA Tax Policy and Controversy Leader

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It remains to be seen, but this may cause large US technology companies to wonder if the localization of existing functions in Europe would stay really accurate in the future landscape (higher corporate tax, transfer pricing uncertainty, challenge around IP) and move assets and functions away from low-tax European countries back to the US.

A new dimension to tax competitiveness

Until quite recently, tax was a real game changer in determining the attractiveness of European countries for foreign investment.

But this has changed in recent years because most countries – now broadly have the same approach to tax. Any differences have been eroded, partly as a result of the EU's efforts to stabilize and standardize tax policy. In addition, the Code of Conduct Group, which investigates aggressive tax competition and the use of State aid regulations to stop countries from using certain tax features of mechanisms, has created uniformity.

President Biden's proposals could make corporate tax even less of a competitive differentiator because they call for the minimum level of taxation, which is higher than the rate in low-tax countries. So the proposals may harm the attractiveness of lower-CIT European countries.

But this doesn't mean that there is no longer any tax competition between countries. Rather, it is likely to shift from corporate tax to indirect tax, as well as new types of tax such as environmental taxes, individual income tax and social security payments. In addition, countries will try to differentiate themselves by how welcoming they are to investors. For example, do they offer cooperative compliance processes? Is the DNA of the

tax administration focused on flexibility and pragmatism? Will they help foreign investors discover local rules and generally ease the compliance process?

Changing digital taxation could make tech giants think twice about Europe

There is so much complexity around digital taxes, with many unanswered questions. It will therefore be difficult to reach consensus on a unified approach. Despite this, governments and courts have changed the way they assess transfer pricing issues so that more revenue is attributed to their jurisdiction. Multinational digital corporations realize that they will have to pay more tax in the place of consumption – though not a huge amount more – and will adapt. It remains to be seen, but this may cause large US technology companies to wonder if the localization of existing functions in Europe is optimal in a future landscape of higher corporate tax, transfer pricing uncertainty and IP challenges. As a result, they may move assets and functions away from low-tax European countries back to the US.

Jean-Pierre Lieb

EY EMEIA Tax Policy and Controversy Leader

Methodology

The “real” attractiveness of Europe for foreign investors

The evaluation of the reality of FDI in Europe is based on the EY European Investment Monitor (EIM), the EY proprietary database produced in collaboration with OCO.

This database tracks the FDI projects that have resulted in the creation of new facilities and jobs. By excluding portfolio investments and mergers and acquisitions (M&A), it shows the reality of investment in manufacturing and services by foreign companies across the continent. Data on FDI is widely available.

An investment in a company is normally included in FDI data if the foreign investor acquires more than 10% of the company's equity and takes a role in its management. FDI includes equity capital, reinvested earnings and intracompany loans.

To confirm the accuracy of the data collected, the research teams aim to directly contact more than 70% of the companies undertaking these investments. The following categories of investment projects are excluded from the EY EIM:

- ▶ M&A and joint ventures (unless these result in new facilities or new jobs being created)
- ▶ License agreements
- ▶ Retail and leisure facilities, hotels and real estate*
- ▶ Utilities (including telecommunications networks, airports, ports and other fixed infrastructure)*
- ▶ Extraction activities (ores, minerals and fuels)*
- ▶ Portfolio investments (pensions, insurance and financial funds)
- ▶ Factory and other production replacement investments (e.g., replacing old machinery without creating new employment)
- ▶ Nonprofit organizations (charitable foundations, trade associations and government bodies)

*Investment projects by companies in these categories are included in certain instances: e.g., details of a specific new hotel investment or retail outlet would not be recorded, but if the hotel or retail company were to establish a headquarters facility or a distribution center, this project would qualify for inclusion in the database.

However, our figures also include investments in physical assets, such as plant and equipment. This data provides valuable insights into:

- ▶ How FDI projects are undertaken
- ▶ What activities are invested in
- ▶ Where projects are located
- ▶ Who is carrying out these projects

The EY EIM is a leading online information provider that tracks inward investment across Europe. This flagship business information tool is the most detailed source of data on cross-border investment projects and trends throughout Europe. The EY EIM is frequently used by government bodies, private sector organizations and corporations looking to identify significant trends in employment, industry, business and investment.

The EY EIM database focuses on investment announcements, the number of new jobs created and, where identifiable, the associated capital investment. Projects are identified through the daily monitoring of more than 10,000 news sources.

The perceived attractiveness of Europe and its competitors by foreign investors

We define the attractiveness of a location as a combination of image, investor confidence, and the perception of a country's or area's ability to provide the most competitive benefits for FDI. The field research was conducted by Euromoney in March and April 2021 via online surveys, based on a representative panel of 550 international decision-makers.



About the EY attractiveness program

Additional sources

- ▶ [Why remote working is the way forward](#)
EY – Global
- ▶ EY – FDI Center of Excellence
- ▶ European Commission, OCO, OECD, World Bank, IMF, United Nations Conference on Trade and Development, Financial Times, JLL

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EY Attractiveness surveys are widely recognized by clients, media, governments and major public stakeholders as a key source of insight into FDI. Examining the attractiveness of a particular region or country as an investment destination, the surveys are designed to help businesses make investment decisions and governments remove barriers to growth. A two-step methodology analyzes both the reality and perception of FDI in the country or region.

Findings are based on the views of representative panels of international and local opinion leaders and decision-makers.

The program has a 20-year legacy and has produced in-depth studies for Europe, a large number of European countries, Africa, the Mediterranean region, India, Japan, South America, Turkey and Kazakhstan.

For more information, please visit:
ey.com/attractiveness #EYAttract

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