HOUSE OF COMMONS

International Trade Committee

Oral evidence: The Covid-19 Pandemic and International Trade, HC 286

Wednesday 13 May 2020

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Watch the meeting

Members present: Angus Brendan MacNeil (Chair); Robert Courts; Mark Garnier; Paul Girvan; Sir Mark Hendrick; Mark Menzies; Martin Vickers; Matt Western; Mick Whitley; Craig Williams.

Questions 189 - 215

Witnesses

I: John Drummond, Head of Trade in Services Division, Trade and Agriculture Directorate, OECD; Vivienne Stern, Director of Universities UK International; and Miles Celic, Chief Executive Officer, TheCityUK.

II: Courtney Fingar, Foreign Direct Investment Editor, New Statesman Media Group; Laura Bannister, Senior Adviser, Trade Justice Movement; and Dr James X Zhan, Director of the Investment and Enterprise Division, UN Conference on Trade and Development.

Written evidence from witnesses:

– Laura Bannister

Examination of witnesses

Witnesses: Courtney Fingar, Laura Bannister and Dr James X Zhan.

Q189 **Chair:** We move on now to the second panel to look at the effects of the pandemic on foreign direct investment. Do we have our second panel ready and waiting? We do, yes; I am seeing the nods. I will ask them to introduce themselves in the manner they would like, and I will start first with Courtney.

Courtney Fingar: I am Courtney Fingar. I am the FDI Editor at NS Media Group, which is publisher of *New Statesman* magazine and a range of business-to-business publications.

Laura Bannister: I am Laura Bannister from the Trade Justice Movement. It is a network of around 60 organisations that are working on trade policy and trade deals, and exploring the justice and sustainability aspects of those.

Dr Zhan: My name is James Zhan. I am the Director of Investment and Enterprise and also Editor-in-Chief of *UN World Investment Report* at the United Nations Conference on Trade and Development in Geneva.

Q190 **Chair:** Thank you very much. Dr Zhan, first, a scene-setter for us, because we had the inquiry into foreign direct investment in the last Parliament, and we have had some interesting things before. Just explain the difference, because it is useful to be reminded of it, between foreign direct investment and mergers and acquisitions—*[Inaudible]*—of the Covid-19 pandemic on the flow of these two distinct forms of investment.

Dr Zhan: Sorry, Chair, I missed the first part of the question. There was a problem with the sound.

Chair: It is probably at my end. It is basically to outline the difference for the Committee between foreign direct investment and mergers and acquisitions. It is quite an important distinction for us to be reminded of. We have done work on this in the past, but it is good in the context of this new inquiry that we have that from our witness in black and white.

Dr Zhan: Greenfield investment and mergers and acquisitions are two types of, or what we call modes of entry for, foreign investment. Greenfield investment refers to new business set up by foreign investors in a host country, while cross-border mergers and acquisitions are basically acquisitions of existing local businesses by foreign investors. That is the difference between the two.

In terms of contribution to the economy, the greenfield investment is at productive capacity right away. It creates jobs, possible exports, and technology and capital, of course. For cross-border mergers and acquisitions, short-term wise, it is injecting capital and provides opportunities for business restructuring and domestic business exit. Longer-term wise, it depends on the operation and it depends on the buyers of the investment.

Q191 **Chair:** Is the pandemic virus affecting them both in the same way, or are there differences in sectors of industry? Are we seeing different levels of disruption?

Dr Zhan: Both modes of entry have been affected significantly but differently. In a sense, for greenfield investment it is because of the uncertainty, because of the demand shock and supply chain interruptions. For those that are multinational companies, they postpone their investment plans or they simply abandon their plans; it depends on how they re-evaluate the situation. Also, there are ongoing investment plans that have been delayed because of the pandemic.

For cross-border mergers and acquisitions, these are also seriously affected. That is partly because of the sudden change of the investment climate and the business conditions, but also because of the slowdown of the Government in reviewing all these cross-border mergers and acquisitions. Some Governments have put in measures to strengthen the screening, and some Governments even suspend the liberalisation.

It affects the two modes of entry differently, but both have been seriously affected and the impact is hugely significant.

Q192 **Chair:** How might these impacts be mitigated? Governments will have an instinctive response to this that may not be the best thing to be doing for the medium to longer term, but it might seem difficult for them in the short term.

Dr Zhan: At this stage, if you look at what the Governments and the investment promotion agencies are doing, they are at the stage of more investment retention. Investment retention means that they try to facilitate the affiliates already in the country to help them to survive and to resolve the issues caused by the pandemic and all these crises, the supply chain disruption and operations and also the sharp decline of the demands. The measures related to facilitating investment—for example, alleviation of administrative burden and the bureaucratic obstacles for firms, or those that relate to aftercare services to investment by the investment promotion agencies—they try to do some Covid-19 related information services, administrative or operational support during the crisis, or provide incentives. For example, some countries provide financial and fiscal incentives to produce Covid-19 related medical equipment, incentives for enhancement of contracted economic activities, and incentives for conversion of production or repurposing.

There is also state participation in crisis-affected industries. That is injecting capital and to a certain extent also nationalising some business firms in order to save them. Of course, supporting the local SMEs is another angle to support supply chains, especially SMEs, to continue to support the global value chains, and they provide financial or fiscal support for domestic suppliers, particularly SMEs. There are other concerns that they want to address, but these are the supportive measures for supporting—

Q193 **Chair:** There are a number of points you have made there. The problem is time, as ever, but there is one I would like to pick up on before I go to Paul Girvan. *[Inaudible]* Do you think many Governments across the world will be doing that to provide a bridge over this crisis of nationalising? I assume you—*[Inaudible]*—short term or a mixture of both.

Dr Zhan: Sorry, Chair. I missed your first part again when you lowered your hand and then the sound gets bad.

Chair: I basically wanted to pick up on the point you were making there. You made a number of good points, but one particularly caught my ear. The injection of capital was—*[Inaudible]*. Will a number of Governments, do you think, be nationalising companies in particular strategic industries within their countries to make sure they bridge out of this period? If they do nationalise them, how much of a period might they nationalise them for?

Dr Zhan: This nationalisation is temporary, in most of the cases. It is simply because of the injection of the capital at a time when companies are in difficulties. For that, when they inject the capital, of course, they hold equity. Normally, it is short term and they just try to help the firms to survive, and then after the crisis they gradually phase it out. This has been the case for the 2008 financial crisis. A lot of companies are injecting capital. Normally, it is short term, helping the firms.

Chair: That is fine. I am quite relaxed with it, but I just asked the question to save heart failure among my esteemed Conservative colleagues.

Q194 **Paul Girvan:** James, I should like to thank you for what you have put forward there. What is known about the effect of the pandemic on investment earnings, and how is it likely to affect investment levels, given the extent to which earnings tend to be reinvested?

Dr Zhan: FDI consists of three components: equity, intercompany loans and reinvestment of earnings. Over the past three to four years, reinvestment of earnings accounted for close to 50% of the global FDI. Because of that, reinvestment of earnings plays a key role.

We have done the survey recently of the 5,000 largest companies worldwide to see how they revised their forecasts for earnings, and in fact they all revised them downward. That was by the end of March. I think there are more companies doing even further downward forecasting. By the end of March, basically what we have seen is on average a 30% reduction of their earnings forecast, and we see for some sectors it is even bigger. For some sectors it is as big as a 200% decline, as they forecasted. Of course, it depends on the sectors. Particularly in the commodities areas, for companies doing raw materials and energy, they are hardest hit. Automobiles, of course, and some service sectors, tourism, were hit very hard by that.

The downward pressure on investment earnings is the indicator for FDI flows moving downward. I mentioned earlier there is an impact on cross-border mergers and acquisitions and an impact on greenfield investment, so equity investment will decline a lot. We see a 50% to 70% decline possibility for this year, for these two months, and then we see to a lesser extent the impact on intrafirm loans. In case some important affiliates are in financial difficulties, the parent firms may inject capital to the firms to offset a bit of the impact.

Chair: The next area is shared between Martin Vickers and Mark Garnier. Martin Vickers, I will go to you first.

Q195 **Martin Vickers:** The question is specifically for Courtney, though other witnesses may wish to contribute. What information is there on how British foreign direct investment, both inward and outward, is being affected by the current circumstances?

Courtney Fingar: Thank you for the question. If we look quite separately, cross-border deal activities, so inbound deals into the UK, have not seen a real drop-off, unlike the global figures. According to global data, inbound cross-border deals coming into the UK in the first quarter numbered 280, and this compares with 204 in Q1 2019, so there was actually an increase. By "deals", we are including M&A, including asset transactions, private equity and venture capital deals, and these would be those that are both announced and completed. What that suggests is that deal activity is still quite healthy.

When we look at greenfield investment—and James, of course, explained the difference in the two—so tangible, physical facilities in a country, it is a little harder to measure in the very short term. Because they are long-term projects, the way the information is collected you might not know about one until later on. It is very hard to get reactive information on that, but there are a few sources out there that give us an indication of what is going on. fDi Markets, which is the *Financial Times* database for greenfield, reported a significant drop in inbound greenfield FDI projects in Q1 into the UK. If we compare it to the same quarter last year, that is a drop of something like 70%, so that is quite stark. The biggest drop came in March as the crisis really took hold.

Another source is Bureau van Dijk, which reports UK greenfield projects down 15% year on year. What you can tell here is that it is very difficult to get a true measure because the ways that these are reported and collected are quite different. Bureau van Dijk shows that the value of the projects, so the pound value, is down by 77%. However you look at it, we can say that the deals value is performing better than greenfield investment, but I think this would be expected. At least in relation to the decrease in greenfield investment, as James would have explained, this is in line with the global drop-off that we are expecting.

In the case of the UK, it is a case of a bit of a one-two punch, though, because companies were already trying to get to grips with the changes brought on by Brexit. There had been quite an immediate, big decline in greenfield investment into the UK immediately following the vote. It had since stabilised. However, what we were seeing is that while project numbers had rebounded a bit into the UK, the size of those projects had become significantly smaller, and that is as companies were starting to hedge a bit, maybe not putting everything in the UK because they would need a toehold in Europe and other places as well.

I think that the FDI situation of the UK is a little bit of a challenge because having a crisis of this magnitude following existing uncertainty surrounding Brexit makes it a difficult proposition. However, this will be the case and probably most countries around the world are going to struggle with their FDI in the short term.

In relation to outbound greenfield projects, they have halved in Q1 of this year compared to Q1 last year. That is according to the *FT*'s database again. Just like companies everywhere, UK companies are pulling back on some of those plans until they understand what will happen in relation to the global market.

Dr Zhan: I just wish to share with the Committee the prospects for global FDI and when it will recover. I thought that could be an interesting question.

What we have seen is that global FDI will behave differently from GDP and trade. According to the forecast of international organisations, GDP and global trade may recover in 2021. That could be sort of a V shape. For global FDI, we do not expect a V shape kind of a recovery—at most, we expect a U shape. The pessimistic view is that it could be an L shape. Why we say that is because, in experience, there is a time lag after recovery between GDP and trade on the one hand and FDI on the other. Normally, it takes a longer time, six months to one year, and that was the experience in 2008 and the 2009 recovery. For FDI, we expect it to decline this year up to 40% and next year maybe up to 10%. That is the prospect we can see, and that will impact on the global value chain, which has been suffering from gross stagnation over the past five years.

Courtney Fingar: If I may add one further point, which is an interesting thing we have seen in the greenfield figures anyway, there is obviously quite a close correlation between how well countries have handled the crisis or how much they have suffered from the pandemic and how their FDI levels have performed. There are countries such as Poland that have bucked the downward trend, where we are seeing greenfield decreases in most countries of the world, but Poland, which for various reasons has not suffered a major outbreak and is widely seen to have handled the crisis relatively well, has seen a raft of large announcements and its FDI levels are quite steady. However well a country copes with the crisis and rebounds from the crisis is going to be intrinsically linked with its FDI fortunes.

Martin Vickers: Thank you.

Chair: That is an interesting fact.

Q196 **Mark Garnier:** Courtney, can I just pick up on something you were saying a little bit earlier where you were saying that the drop-off of foreign direct investment into the UK was as a result of uncertainty about Brexit and all the rest of it? One of the interesting statistics that slightly counters that is that the UK is still the third biggest destination for foreign direct investment after, I think, the US and Hong Kong, so there is still quite a lot of appetite coming into it. This refers slightly back to the point that Dr Zhan was making about the fact that we are seeing a drop-off in general in global foreign direct investment, both out from the UK and also obviously into the UK.

I suppose my question is slightly more philosophical than direct. Given the fact that there is this ongoing trend of a drop-off of FDI anyway, is it not the case that actually what is happening with this Covid thing may almost stir it up into a point where it might become more interesting again? It sounds slightly counterintuitive, but clearly what is happening is nobody is going to want to invest in another country at the moment because you just have uncertainty about a whole load of different things, including, of course, how much money you have yourself and how the economies are going to perform. When this is all over, are you not going to end up with a situation where valuations have been thrown up in the air of opportunities, and you may find greater opportunities in terms of economies refreshing themselves, so you might see a pickup in foreign direct investment?

Courtney Fingar: It is true that when you have a crisis, it is throwing the chessboard into the air in a certain respect, and it is a chance to rethink and reconsider strategies for the companies themselves. We are definitely seeing that with the reassessment of global value chains and how companies run their supply chains, which has FDI implications. It is also a chance for countries as well to reassess their strengths as investment destinations and to adapt their own strategies, so that is, philosophically anyway, very true.

Q197 **Mark Garnier:** One of the numbers that I was looking at, which was very striking, was the outward direct investment from the UK, which went down from £99.5 billion in 2017 to £6.3 billion in 2018, which seemed an absolutely colossal drop in what I would refer to as ODI. Certainly, it was the case prior to the setting up of the Trade Department in 2016 that outward direct investment was actively deterred by the Government. They were actively saying, "We are not prepared to actively support outward direct investment", because it was seen as offshoring jobs, whereas, once the Trade Department came in, overseas direct investment was seen as generating income overseas and was export promotion. Why have we seen anyway this massive drop-off of outward direct investment from the UK from 2017 to 2018?

Courtney Fingar: James might have something to add on this, and it would just be a little bit of speculation. However, I would say it is a combination of factors. First, even for UK companies with uncertainty surrounding Brexit—and they might not have even viewed it as good or bad, but just not knowing the way the land was going to lie—they would need to hold off and wait and see. Do they need to put more physical facilities in Europe, for example? Maybe they would be able to access it, maybe they would not, kind of shoring up and waiting to see. We saw that, in some respects, about investment into the UK from some companies, but we also saw it outbound. Also, just the general mood of the market. We have seen a wave of protectionism.

As you mentioned, there are many Governments in the world that were trying to incentivise companies to stay home and making FDI inward or outward a little bit of a bad word, and we saw protectionism in many key markets, which made the operating environment for overseas investment also quite difficult. I think that has led to caution for companies around the world in any destination. I would say those factors were a little bit in the minds of UK companies, but probably also just waiting to see. You would rather wait and see than invest in a large facility in the UK that you might not need or invest in a large facility in Germany or France that you may or may not need, depending on what trade arrangements were struck.

It should be mentioned that M&A investment is much more reactive, and for other types of investment, like portfolio investment, you can react quite quickly. When we talk about greenfield projects, these are very long-term plans usually, and you do not want to be kneejerk and you do not want to be reactive. You would prefer to wait and see what you would be dealing with.

Q198 **Mark Garnier:** Dr Zhan, can I just very quickly ask a slightly separate question on your definition of investment and that differential between what is greenfield investment and mergers and acquisitions? Just one, again, economic point about this. A merger and acquisition is merely a stock market transaction where you are buying existing shares from one existing shareholder to be transferred to another. You could have a UK-based company but owned by a French company, if you take it over. In the case of SoftBank buying ARM Holdings, where that was a £22 billion investment, that was not necessarily £22 billion coming into the UK. It was £22 billion being transferred from one shareholder to another.

I just think this difference between what is greenfield and what is mergers and acquisitions is incredibly important for the economics of a country, because if you see greenfield investment coming in, that is new money coming into your economy. That is a current account effect directly, and you see investment coming in, almost to the point where

M&A activity is worthless to the economy of a country. It is only further direct investment that is coming in to expand an operation like ARM Holdings with more investment, or it is a greenfield investment where you are literally creating new employment and economic activity. Is that a fair assumption?

Dr Zhan: Yes and no. Yes, there are types of cross-border mergers and acquisitions that are exactly what you have said and the way the transaction is made, but there are also other different types of cross-border mergers and acquisitions. Cross-border mergers are likely to have the mode of entry you mentioned, and there are also acquisitions of some companies simply just to inject cash to buy the company or to buy parts of the company. Sometimes they bring in technology; they bring in access to the market. Simply, they just get into the joint venture with the existing firms in the country. In that sense, they play a role, and perhaps they have a role of helping the companies to restructure, and also to provide an option for domestic firms to exit or partially exit and save the funds for something else. That adds value to the country.

There is also the issue that at a time of crisis, when you have a lot of companies in difficulties or assets in stress, of course, the price will go down of the assets, and then that may trigger fire sales. However, if you have more buyers, then, of course, you are a whole lot better. It gives more business opportunities for the domestic firms. It all depends. If the buyer is a vulture capitalist or some opportunist, that may be detrimental. It all depends, and it also depends on the longer term, whether the investor, through the cross-border merger or acquisition, really has a long-term view of holding that and then making the business sustainable.

Mark Garnier: Fantastic. Thank you very much.

Chair: Now to our cross-border acquisition for the constituency of Fylde, Mark Menzies. You were wondering when I was going to make that link.

Q199 **Mark Menzies:** I would put nothing past you, Chair.

My question is to Dr James Zhan, to begin with. Investment promotion agencies are involved in promoting and facilitating inward foreign direct investment, as well as providing the aftercare to investors. What roles are those bodies playing in responding to the impact of this current pandemic?

Dr Zhan: At this stage, investment promotion agencies in different countries have different roles and different affiliations. Some of them are part of the Government. Others are simply private sector driven. They provide services, and normally they have four functions. The first is investment promotion, the second is facilitation, and the third is aftercare services, meaning once the investment is landed in a country, in operation, when there are problems they help with troubleshooting. The fourth one is advocacy, because they work with the investors, so they know the problems and will try to react and then provide some proposals to Government for that.

In the case of the UK, the DIT has the function of both Government and investment promotion, and the policy advocacy, aftercare and investment promotion targeting are all there.

At the time of the crisis, of course, they provided services more to do with retaining the existing investment, or trying to secure those investments already in the pipeline to all the investment already ongoing. As you know, for some greenfield investments, they come in stages. You have to deal with the facilities for production, and then putting in the capital equipment, and then the operation. There are various stages. At this stage, the key is to ensure the continuation of the projects, and it is very important to help them. That will secure those potentially viable businesses and enable them to be on the ground and immediately operational or in operation after the crisis.

Q200 **Mark Menzies:** That is great. Courtney Fingar, how has the Department for International Trade adapted its role as the UK's national investment promotion agency in light of the pandemic?

Courtney Fingar: When you are judging how an agency is reacting, you can consider what it is doing and how it is communicating what it is doing. In some respects, you can judge the former on the latter.

I just did a little bit of a search on the Government webpage, so the official page for DIT. One of the things that emerges in a crisis like this is that interacting with and communicating with existing investors, but also giving the messaging to prospective investors, is really paramount. If we look at the webpage, there is a blurb running across all the Government's pages saying, "Coronavirus guidance and support". Good, but it is quite generic. If you click on it, it is general health advice. It lists some things about business, but it is not specific to investors or even to business, necessarily.

On DIT's page there is a link saying, "Support for exporters and inward investors", which is good, but if you follow that, there is a lot more on trade than investment. This points to what I have as a broader concern about how things have been structured. It is a pitfall when you have agencies that are focused on the trade and investment, which is that the two tend to be viewed as the same thing. Obviously, trade and investment are both important, but they are not the same thing and they need to be treated quite differently. Most of the information that you will find from DIT is very focused on trade, much more than investment. If I am an investor and I am looking from the outside, it would not really be immediately obvious to me that the Department is where I should go, not even just because of the name but also in its communication.

All the focus of the page and of the language is mostly around exports, which is important, but not every inward investor is an exporter. Not every company investing is exporting. The question is: how is DIT speaking to them? How is it supporting them? What is the messaging and what is the tangible way of engaging with them?

I see that there is a Covid-19 block again that lists support measures. Again, good, but not all of them are relevant to inward investors. Actually, most of them are not. Even if support measures are broadly the same for domestic as opposed to international companies, which is often the case, there still needs to be targeted messaging for inward investors. They need to have a place they can go and understand that this is the portal or the agency to help them. They have to have dedicated information and support.

I just wanted to add one thing. International comparison is important. If I go, for example, to Business France, which is the inward investment agency for France, so the counterpart, I see an alert message at the very top of the page saying, "Covid-19. We're here for you, for our investors. We're helping you". If I click on a button for investing in France, I immediately get a page listing Covid-19 support measures directly for inward investors with a drop-down menu of frequently asked questions and all the support. I think it would be great if the UK would consider something similar and work on their messaging as much as the actual support.

Mark Menzies: That is a great recommendation, really good. Thanks very much.

Chair: It is not really a difficult thing to do because you just have to go and click in the French pages and see what they have done. The wheel has been invented.

Q201 **Craig Williams:** I wonder whether I could focus particularly on FDI and more on the screening and national security angle. Several countries around the world are putting in more protective measures. I do preface this question with: we are very happy in the middle of Wales with a lot of FDI and we encourage it but, equally, the countries that are putting these controls in—I wonder whether I could go to James first and have your views on those measures and how desirable seeing these measures around the world are.

Dr Zhan: Thank you for the question. This is an extremely challenging question, and we have seen that quite a number of Governments, especially from advanced countries, have put in place new screening procedures for foreign direct investment. This is for the concern of national security and public health also at this time of the pandemic. In fact, they use different methods to do that.

It is understandable because at this stage the asset price is very low, and it becomes an opportunity for investors, both serious opportunities that some countries are putting in place. They are also afraid of losing the "strategic assets", in particular technology and R&D facilities, and they think this is the competitive advantage of the country. It is understandable. The issue is how to define it, define those industries or the facilities that are considered to be the national security or strategic assets, so to speak, including strategic infrastructure. These are very important considerations.

The second is what type of mode of entry the foreign investors are getting in and whether they really come in to have overall control of the firm or they are just injecting capital and have an investment interest in that. Also, over the years, what is their longer-term objective? Some of them really want to acquire and then move back home the facilities or strategic assets, or they really just want to have it in the host country for longer-term development and even for strategic partnership for technology developments. It all depends. For Government, it is a matter of how to carefully do this and also keep the economy open for other types of investment that the country needs, and also the further opportunity of strategic partnership, which is very important in the R&D and technology areas.

Q202 **Craig Williams:** I wonder, before we bring Courtney in, whether I could tease a little bit more out of you, James, and then go straight to Courtney with this question. Currently, we have the Enterprise Act from 2002 and the Queen's Speech. We have the national security and investment Bill coming forward. We already have powers. What is the role of state actors in FDI around the world, and is that driving some of the protectionary measures?

Courtney, in terms of the Bill that will be coming forward, what would you like to see, or do you have any general comments on this particular problem?

Dr Zhan: I missed the wording. You said the state?

Craig Williams: State actors in terms of FDI, so as well as private agencies.

Dr Zhan: State actors in FDI are more about creating the enabling framework to regulate. We see how Governments create a stable, predictable and transparent investment climate for investors to come in, and also the state has a role to ensure that investment, once it gets into the country, contributes to sustainable development of the country. That is very important. That is why we see that Governments play a role in the regulation.

Basically, it is a balance of the rights and obligations between firms and the states in this enabling framework or environment, on the one hand to provide the protection and facilitation to foreign investors, and on the other hand that the Government should have the flexibility and the right to regulate, flexibility in times of crisis like this, that they are able to put in measures on that. That has serious implications in international investment treaties, as the UK has quite a number of them.

Chair: Can we hear from Laura Bannister at some stage in this, as well?

Craig Williams: Yes, sorry.

Courtney Fingar: Yes, thank you. I will be brief, in that case. In general, the reform—*[Inaudible.]*

Q203 **Chair:** That was very brief. Laura, I think we had cued you in and had you ready for this, maybe.

Laura Bannister: I think I am here to talk about some slightly different issues to do with investment policy that have not been brought up yet. The really key issue that we wanted to bring to the table is the question of investor state dispute settlement. The Covid-19 crisis puts us enormously at risk of a slew of cases that come through the ISDS mechanism.

Just for clarity, the UK has 91 bilateral investment treaties in force with countries all over the world. Many of those are developing countries that do not have a lot of investment in the UK, but some are not. We have investment agreements with Singapore, for instance, and with Hong Kong—places where there will be many investors who have investments in the UK. Therefore, we are at risk of cases under this mechanism.

Countries all over the world, including the UK, have taken measures in response to the crisis that could be considered to be in breach—or would almost certainly be considered in breach—of our obligations under investment agreements. These obligations are very broad. They give investors the right to fair and equitable treatment, for instance, full protection and security. They protect against indirect expropriation, which is actions that effectively devalue an investor's investment.

The UK has already taken a lot of actions that would violate those protections. The Government advised banks to suspend pay-outs to shareholders and bonuses, so that led to £7.5 billion not being paid out. That is something that investors could certainly complain was a form of unfair treatment that breached their investment obligations. Another is simply the enforced closure of businesses and telling people to stay at home, effectively removing customers from those businesses, pretty much indirectly expropriating the value of their investment. We are really at risk, and many other countries have taken many other measures that put them at risk.

What I would really like to get across is that there is a potential crisis coming in ISDS cases. Law firms are already ramping up to take part in this and to lead the way on this. I just want to give you some quotes from law firms to make that clear. Debevoise & Plimpton has said, "Investment arbitrations often follow economic, financial or other crisis", so we should not be deceived that companies would not dare to bring cases because this has been a global experience. I think it is very likely. Aceris Law agrees. It said that there have been a lot of measures that violate various protections taken in response to the Covid-19 pandemic. Others have said this is likely to be the beginning of a boom, and one of the third party funders—because this is often funded on a no-win, no-fee basis—said, "Frankly, we're drinking from a fire hose", in terms of the level of cases that it is experiencing.

Chair: Wow.

Laura Bannister: I just want to make two points on ISDS before I go. The first is that this could be absolutely terrible for the UK. The level of claims is extreme. The level of compensation is extreme. We are talking about the hundreds of millions, potentially billions, that companies can claim. Say an airline claims for being told it has to ground its planes. Once one company succeeds in a claim, of course, you can then get a rash of claims from other companies. We could be talking about losses in the many billions for the UK budget, which can have huge impacts on public spending, on the NHS, and ultimately on people and potentially lives lost.

The impacts on developing countries, because of course these treaties go both ways, could be extreme as well. You can envisage some really ugly cases with prominent UK firms taking developing countries' Governments to court for measures that they took in response to the pandemic, which I do not think would be a good look or something that people here would support.

The important point to make about this is that we can completely avoid this crisis through some very easy policy measures, but we have to act before these claims start to come in. The first thing that we need to do, and we can take this step immediately, is a withdrawal of consent to arbitration. The consent mechanism within these deals is kind of preliminary. If we withdraw that consent, we create a lot of legal uncertainties that make it hard for these claims to proceed. The second is that we need to start negotiations towards mutual termination so that we are ultimately properly protected, and that Governments are then free to take the measures that they need to in response to emergencies like this.

Courtney Fingar: May I say that I am very sorry for the fact that my Zoom crashed at a horrible moment?

Q204 **Chair:** You did say you were going to be brief. You surprised us with how brief you were.

Courtney Fingar: I was serious about that. I will not belabour the point, only to answer Mr Williams's question. Without doing a fine legal reading of it, which should come from a lawyer, it seems to me that the proposed reforms by the UK with relation to investment screening are quite in line with the way that other countries are doing it, and much in line with international norms. All investors really want to see is that there is a clear mechanism, that they would be treated fairly, and also that the cases would be heard quite promptly. It seems that the legislation is allowing for that. The trigger test for the scenarios that would trigger such an investigation is clear and they are not unreasonable. That is all I should really say on that, so as not to take any more time.

Q205 **Sir Mark Hendrick:** This question is directed to Laura. Obviously, you are quite well known for advocating suspending intellectual property provisions for Covid-19 related items. How do you respond to the argument from the British pharmaceutical industry that, without patent protection, the industry would not spend the $180 billion a year it does on research and development? Do you see it as a disincentive for industry to invest in research and development in the way that it has in the past?

Laura Bannister: First of all, I need to make it clear that we are not calling for the suspension of all intellectual property protection. Most intellectual property protection is handled at a national level. We are a trade policy organisation.

Sir Mark Hendrick: I said for Covid-19 related items.

Laura Bannister: Yes, but what I am saying is we are talking about suspending the measures in trade agreements that relate to intellectual property, not all intellectual property.

Q206 **Chair:** Would your argument be that these things had been written at a time when a pandemic was not envisaged, or the pandemic is the black swan, if you like, for these trade agreements?

Laura Bannister: What we are facing is a situation where one company is going to come up with a vaccine or an effective treatment, and that one company, in normal times, would have a production monopoly on that product for quite some years. That is likely to very significantly increase prices. Just by way of comparison, there is a hepatitis C drug that is about $300 in generic and $84,000 in its branded version, so there are huge disparities in price when we have production monopolies. The other issue is a production capacity question. If just one company is producing a medicine or a vaccine, we have to wonder how we are going to produce enough quickly enough to bring this pandemic to an end. That has to be the priority at the moment.

Secondly, what we really need to be looking at is how we can ensure that companies that come up with these solutions to the pandemic provide them cheaply. The usual mechanism for doing that is through compulsory licensing. Our big concern, when we say we want to suspend IP provisions in trade agreements, is that we want to open up space for compulsory licensing to at least be considered. In many cases, it is not necessary, but because it is available as an option, companies then respond and lower their prices accordingly.

At the moment, the UK has an issue when it comes to compulsory licensing because of the TRIPS agreement under the WTO. The TRIPS agreement has certain flexibilities, but in 2003 the UK and a number of other countries voluntarily waived their rights to use some of these flexibilities. The details are kind of complicated and I can expand on them if you really want me to, but ultimately the issue is that it would be quite difficult, or it potentially could be difficult, to get significant quantities of generic drugs in a short time into the UK—either the drugs or the active ingredients that make the drugs. We need to open up that space for compulsory licensing by the WTO.

In terms of your question about R&D and how drug companies would fund this, there are a few responses. The first is that a compulsory licence does not get rid of the company's patent. It still has a patented product. It still receives royalties for that drug. It just does not have a monopoly. In every other industry, we are concerned about monopolies. We take action against monopolies for very good reasons because we understand they lead to distortions in the market and problems of supply. All we are advocating for here is a similar approach where we are able to take action against monopolies. Remember here, this is to save lives. This is a public health crisis. This is a good reason. They still get an income from the drugs and the intellectual property that they produce.

The second thing I would like to point out is that pharmaceutical companies make enormous profits at the moment. There is huge wiggle room. In 2018, the profits distributed to shareholders was $146 billion from the top 27 pharmaceutical companies. That is $146 billion of wiggle room that we have before I think we could say that they do not have anything left to invest in R&D. That represented 123% of their R&D budgets. These companies are not about to be stripped of the money that they need to invest in research and development. They have plenty to spare, and we are asking for very reasonable anti-monopoly conditions to be made available via tweaks in the trading arrangements.

Q207 **Sir Mark Hendrick:** Could I ask Courtney and James to respond to that and what their views are on this?

Dr Zhan: Courtney only, please.

Chair: Courtney, on you go. You have been landed in the hot seat.

Courtney Fingar: We have seen a lot of loosening of IP legislation in flexible terms to deal with the crisis, so that is impacting a lot on healthcare and pharmaceutical companies, and there is nothing wrong with that. We need to do that. I would only be wary of pandemic relief measures that can be a Trojan horse for an overall loosening of intellectual property rights that could be detrimental to the investment environment. Strength of IP rights is a fundamental criterion for inward investors. That is purely me looking at it from an FDI perspective.

Of course, we need to balance the public good against that and we need to find the right middle ground but, as an FDI advocate, I would just stress the crucial importance of companies feeling secure in their intellectual property rights.

Q208 **Chair:** Very briefly, Courtney, do you find a mild stress within yourself financially, because you have an FDI hat which you would normally wear in peacetime, and now we are in the middle of a pandemic, so there are a number of tensions within that answer? Would that be a fair comment?

Courtney Fingar: That is very fair, and it is just the same as with any wartime measures—you have to be careful. You need to be able to bring in special wartime measures, but they should not necessarily last forever, and they need to be treated as such and treated as crisis measures. Very often when we have wartime measures—and we saw this in a lot of different ways after 9/11, for example—emergency measures that were put in place never really left us, and instead they just changed the operating environment for people, for national security and for privacy and everything else. I think we have to tread a very fine line.

Q209 **Chair:** Tell me about it—about airports. I am quite enjoying not going through airports, with what is going on at the moment. That is just one upside. Maybe I had better apologise quickly to the airline industry for saying that. James Zhan?

Dr Zhan: I just wish to mention that this is indeed an issue at the moment. We see that the Government have the flexibility to do it. There are multiple conditions in this WTO TRIPS agreement. There is article 31 and 31(b), and that was reiterated in the Doha declaration. The multiple conditions include that compulsory licensing should be granted on a case-by-case assessment and subject to judicial and other independent review; it should be temporary; it should be non-exclusive; and it should be proportionate to the purpose for which it was authorised, with adequate remuneration and, as Laura mentioned, with prior negotiations with patent-holders concerned, except in the case of emergency. There are multiple conditions for that, so the issue is that when Government start doing that, they should take into account all these multiple conditions in the agreement. After all, this is an emergency and in this case it is for public health purposes, so it is a legitimate action.

Q210 **Mick Whitley:** My question is to Laura. You argue in your written evidence that were Governments to take necessary actions to deal with the pandemic, they could fall foul of the investor-state dispute settlement provisions in international investment agreements. Could you explain this and say what you think the consequences might be?

Laura Bannister: Just to reiterate some of the stuff I said earlier—

Mick Whitley: I know what you have said earlier, yes.

Laura Bannister: I think there are a huge range of measures that we have taken as part of the pandemic, but the steps that we have taken are absolutely unprecedented.

Q211 **Chair:** Is your motivation here to say that these agreements were written at a time when the idea of the pandemic being in there was just not an issue, and it is something that has blindsided, perhaps?

Laura Bannister: Yes, absolutely. The kinds of changes in policy that previously have prompted ISDS cases are so minor in comparison to the kinds of policy changes that we are seeing now that it feels unimaginable that companies would not leap on this as an opportunity to make use of cases. Hopefully, some of them will be shamed out of it by simply the nature and extent of the crisis, but there are a lot of companies out there that have suffered very badly, and I think the likelihood of cases is very, very high.

What we need to do as a country and as a Government is to think about whose interests we most need to protect here. We can protect the interests of foreign investors. It is important to remember that ISDS protection only applies to foreign investors. Domestic investors get nothing through this system. Ultimately, it creates a very unlevel playing field. Are we most interested in the interests of foreign investors and shareholders, or are we interested in preserving the wellbeing of people in Britain via their public services and public spending and having that money available?

We do not want any companies to go bust, but when you are balancing those objectives it is clear that surely everybody present is most interested in maintaining a decent public budget for public spending so we can recover from this crisis. I think that is the real impact. If we allow ISDS to continue and to pursue cases in relation to Covid measures, then ultimately we are putting people in Britain, and people all over the world, at huge risk for the sake of the interests of foreign investors. I just do not think that is the right balance and the right way to go.

Q212 **Mick Whitley:** Dr James Zhan and Courtney Fingar, do you agree with the Trade Justice Movement's analysis on this issue, and how far is this an issue that should worry the UK Government?

Courtney Fingar: I think it is a very valid issue to raise, but I worry a little bit about language. Foreign investors are huge employers of British people, and the idea that it is a zero-sum game of inward investors versus the British public or even the British purse is language I am not entirely comfortable with. In terms of Government budget, foreign investor companies supply a huge amount through their taxes and through other support, and also, crucially, the jobs that they provide. Of course, we need to find the right balance, but it does not have to be a zero-sum game.

The issue of investor-state disputes is a really thorny one. We will never solve it in a few minutes, and not even in this entire panel. Again, interests always have to be balanced. These things were brought into place purely to give foreign companies a comfort level when investing in foreign countries to know that they would not be taken advantage of and that, therefore, there was a mechanism for them to lodge a complaint if they felt they had been treated unfairly. Again, we have to find a balance. I am sure Dr Zhan can add to that more coherently.

Dr Zhan: Thank you very much. I think this is one of the heated debates in the area of investment policymaking. In fact, this is a phenomenon we see that relates to the older generation of investment treaties, and there are basically 2,900 such treaties we call the older generation. The UK's financial investment treaties—90 plus—were all negotiated decades ago, so we call them the older generation of investment treaties. The UK was part of the EU, and that is why these treaties did not play a big role in the past, but now it comes to the fore.

What we see are the potential systemic risks. These treaties were negotiated in the past from the perspective of protecting UK investors overseas, so they were mainly concluded with a large number of developing countries where the investment climates were not at that time so stable, predictable or transparent. That is why the treaties were there.

Given the current situation, for the time being we have not seen cases brought up since the crisis, but from past experience in 2008-09, there were a number of cases in other countries, so there is a systemic risk of this. We pointed it out in the UNCTAD Investment Policy Monitor, and I have raised the issue at the G20. In fact, most recently Professor Jeffrey Sachs, together with a few eminent persons, called for a moratorium during the crisis for this ISDS.

In essence, I see Courtney's point. It is a matter of how to balance the rights and obligations between firms and states, and between creating a stable investment climate on the one hand and the Government's right to regulate and flexibility, particularly at the time of the crisis. Overall, we need reform, and the UK has to update its existing investment treaty network. The reform is key and it is timely.

Chair: Thank you. Time is fast hitting us on the back of the head.

Q213 **Martin Vickers:** Could I turn to the investment implications of strengthening supply chain resilience? Clearly, Governments and businesses are considering how to make supply chains more resilient by means such as bringing production closer to home, building excess capacity and moving away from just-in-time methods. What are the implications for the flows and stops of international investment?

Courtney Fingar: Supply chains are obviously really linked to where companies have their global footprint, especially where they produce. There had already been a trend of reassessing supply chains and looking for ways to make them both shorter and stronger, so this is not really a new concept, but I would say Covid has accelerated and heightened the importance of this. The trade-off was always, of course, if we strip it down to its basics, companies looking for more cost-effective places to manufacture. It was worth it to manufacture further afield, if you can do that cost-effectively, so you would have these very long supply chains.

Over time, it was considered—partly out of concern for carbon footprint and other factors—that maybe having these long, spread-out supply chains really did not make so much sense. Automation also comes into this because the factor of cost-effectiveness for labour becomes a little bit less important as we go on, as more and more jobs could be automated. It causes manufacturers to question their whole calculation as to where they would put their production facilities. This emergency has made them think more actively and perhaps more quickly about how to do that.

It is almost certain that there will be some reshoring as an outcome of this reassessment of supply chains—manufacturing closer to home, maybe looking for lower-risk places and closer places, and also diversifying the supply chain so as not to be caught out. It exposed the potential—in the minds of some people—overreliance on China, for example, although it is less geared towards manufacturing than it once was. That could benefit a lot of countries, perhaps developed countries that would like to have operations reshored.

The caveat is that, again, with greenfield investment, these things do not happen overnight. If you have a contract manufacturing deal and other things, you could maybe change that quite quickly. You can change suppliers, but bringing all of your production and creating a whole new facility back in the UK, and thinking about that and this wholesale restructure, is probably going to take some time. We should not get immediately excited about it.

Dr Zhan: I would say this question is really a long-term question. The question is that if we are looking—

Chair: Can we have a short-term answer?

Dr Zhan: Yes, short term rather than long term. This is an extremely important one. In fact, the corporate world is driven by triple drivers, the mega trends. The mega trends are the new industrial revolution, growing economic nationalism and the sustainability imperative. These triple mega trends have applied to the global value chain and international manufacturing networks over the past 10 years. In the 10 years to come, that is what we see, and that will shape the landscape of global investment. We see this Covid-19 crisis as basically a catalyser for this. It will mark the end point for globalisation.

What will happen? Personally, I think that this reshoring, the resilience drive, will eventually not necessarily lead to reshoring, but lead to a restructuring of the global value chain from global to regional. There could be the emergence of a triad in the global production system that is the EU-centred European system, the US-centred American system and the China/Japan-centred east Asia system. That is partly because of geopolitics, partly because of economic nationalism and partly because of trying to make the value chain resilient. Therefore, there is a diversion of the investment and it will lead to diversification. The issue is for countries to see how you balance it, especially for smaller economies that are not like the huge ones. You need to balance the open economy with national economic security, the role of Governments in the private sector, the domestic productive capacity and international competitiveness, because open investment is for that.

I can go on and on. I can see, Chairman, that you want me to wind up. In essence—

Chair: I do not really, but I am afraid I am going to have to. Is that you, then, Mr Vickers?

Martin Vickers: I have some supplementaries, but I will pass on that. Time is against us.

Chair: I am very, very grateful. I will move over to Robert Courts, who will probably be bringing this afternoon's session to a close.

Q214 **Robert Courts:** Just a few quick points from me—nice quick ones, you will be glad to hear.

I wanted to ask about performance requirements and local content rules. Laura, can I ask you about this first, please? In your written evidence, you refer to performance requirements and local content rules as being a means of building domestic resilience against trade disruption, but could you tell us what you think the implications might be for international investment policy rules?

Laura Bannister: Ultimately, I should just say first that we are essentially agnostic about whether localisation is the best approach in responding to this crisis. Clearly, countries are going to restrict—they have done—exports of key goods if there are supply issues. We have seen that with medicines. I know that if the UK had a giant PPE factory at the moment, we would not be exporting it. That brings various justice concerns, but Governments also have a responsibility to provide for their populations. The justice issues here are delicate and balanced.

What we do believe is that countries should have a number of options available to them. They have some difficult questions to answer. Reshoring, re-localising production and regionalising production is one potential solution that might work for certain products, certain industries and certain regions or countries.

At the moment, there are a number of measures in trade policy that work against that, and the ban on performance requirements is one of them. I should say that it is a minor one, and it is not one that applies significantly to the UK. The UK's bilateral investment treaties do not have a ban on performance requirements. Performance requirements, just to clarify, are rules that a certain percentage of the jobs created have to go to local people, for instance, or a certain proportion of a board of directors have to be local people, or it has to use local content. Sometimes they can be about research and development, saying that a certain proportion of revenues has to be spent on research and development, for instance.

Historically, investment agreements did not have much to say about these, with the exception of local content specifically, which is more controversial. Increasingly, those agreements have started to include sections on this, but that is predominantly the investment agreements of the US, Canada and Japan. Partly because we tend to have a bit of an older generation of bilateral investment treaties, we do not have much work to do in this area, so luckily this is something where we can sit back with our existing investment policy and know that that is not a barrier for countries to develop domestic resilience for emergencies.

Q215 **Robert Courts:** Thank you. Could I ask the others, starting with James, please, how you respond to the Trade Justice Movement's views on performance requirements and local content rules, as written and as we have heard now?

Chair: Can I just butt in and say you each have about 40 seconds before the broadcasters drop the axe on us all?

Dr Zhan: The terms were agreed upon in the past, decades ago, but in fact over the past five years there are a proliferation of industrial policies in over 100 countries, and all these industrial development policies really put in place a lot of instruments in trade and investment measures that are inconsistent and potentially inconsistent with the TRIMS agreement. Eventually, I think member states will revisit this issue.

Courtney Fingar: I cannot add a lot to what James said. It is just that all of this has to be worked out. The UK has an added complexity with negotiating trade agreements with the whole world, so the local content requirements are usually falling foul of free trade agreements, bilateral investment treaties and WTO rules. All of that has to be navigated and considered as the UK crafts these trade agreements.

Chair: Thank you, Robert, and thank you to James Zhan, Laura Bannister and Courtney Fingar. We are really up against it at the moment—I will probably get my knuckles rapped at the end of this. We could have spent a lot longer on that. There are huge areas to discuss and to probe further, but thank you for the evidence you have given us for our report. Can I wish you all a very pleasant afternoon? It is absolutely beautiful again here in the Hebrides. It seems to be like this every afternoon that we have a Committee broadcast. I am looking out at the gorgeous sunshine on the machair in front of me. Thank you. Feasgar math—good afternoon, and have a great day.