Regional Studies Association Response to the International Trade Committee Inquiry on Inward Foreign Direct Investment (FDI)

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1. The Regional Studies Association (RSA) is the leading UK-based, international learned society with global membership, representing a cross-disciplinary range of academics and policy makers engaged in questions of regional development.

2. We are pleased to submit this response to the International Trade Committee on inward Foreign Direct Investment which is drafted by those named above and sent on behalf of the RSA's Board.

Background

3. The attraction and retention of inward investment is crucial to the UK economy and its capacity to recover from the Covid-19 pandemic. FDI has become increasingly important to the UK economy and its innovative performance. For example, in 1993 the ONS estimated that 73% of UK business R&D was performed by UK-owned businesses. Yet by 2017 foreign owned businesses undertook the majority (52%) of all business R&D (ONS, 2018).

4. Inward investment into the UK has traditionally offset the UK trade deficit, yet there are concerns that this position might not last. The Covid-19 pandemic is changing the global economy and there are concerns that countries may re-shore production leading to a further decline in globalisation. Alongside this, Brexit has led to a significant fall in inward investment (EY, 2020). Recent estimates by UCL and the LSE suggest inward investment will fall by up to 37% as a result of leaving the EU single market and customs union (UCL News, 19/10/20). This is, therefore, a timely moment to consider how the UK may best attract, retain, and embed inward FDI as well as reinforce the internationalisation of domestic firms.

Responses to consultation questions

How can the Office for Investment most effectively fulfil its remit to "support the landing of high value investment opportunities into the UK", while "ensuring high and rigorous standards of scrutiny and security"?

5. The combined impact of the Covid-19 pandemic and Brexit means that the Office for Investment will come into being in a difficult and uncertain period. UK national economic performance has been highly geographically uneven, and there is a clear need for a targeted approach to FDI promotion and retention at both national and local levels.

6. **The RSA calls for the Office for Investment to take a regional approach.** The "driving inward investment into all corners of the UK" strategy needs to be informed by the specialisations and comparative advantages of different sectors and regions as well as by the features of the relevant investment eco-systems (World Bank, 2020). The UK will not be the only country seeking to attract inward investment - many locations will be chasing the same, often high-tech sectors. Investors are often choosing between similar regions in different countries, rather than choosing 'country first'.

7. **Empirical evidence suggests regional approaches to FDI attraction outperform national approaches.** There is relatively little evidence on the success - or otherwise - of regional investment proposition agencies (IPAs). One exception is Crescenzi et al.'s (2019) study which shows - using two different econometric methodologies - that IPAs are more effective at the regional than the national level, increasing both the number and amount of FDI inflows. Importantly for the 'levelling up' agenda these effects are larger in regions with weaker economies, providing powerful evidence for a local-led approach.

8. **Policymakers need to consider the retention of FDI, as well as attraction.** This will be an increasingly important concern, in particular due to the re-shoring strategies promoted by many countries. Several studies have shown that where a firm undergoes divestment - i.e., is sold to local owners - this is accompanied by a decline in output, profits, as well as export and import activity in the firm (Javorcik and Poelhekke, 2017). In this regard the 'connectivity' of foreign firms with local, national, and global value chains is of paramount importance to minimise incentives for divestment and retain foreign capital (Crescenzi and Harman, 2018).

9. **Integrate local skills policy with FDI attraction.** Local skills policy plays a critical role in the attraction of FDI. However, the UK's educational system is still highly centralised - including, importantly, technical education. There is considerable scope for local businesses to further develop curricula and training, tailored to local demands, especially as most FE students remain very local (Morris et al. 2020). Germany offers a good example of how this can be done: local firms collaborate with educational institutions, chambers of commerce and länder governments.

10. The UK has many strong universities, but these need stronger incentives to engage with local actors. At present, the higher education research and teaching evaluation frameworks offer no such incentives, based as they are on national criteria. The establishment of Skills Advisory Panels (SAPs) will hopefully herald a change in direction and open opportunities for more local input on curricula design to overcome regional skills bottlenecks. This can aid new business creation, encourage new investment, and business retention, helping attract foreign-owned companies. It will critical to ensure the SAPs have more powers and appropriate funding to shape training programmes in line with spatiality-specific needs and aspirations. This is likely to include an increased emphasis on providing and equipping the workforce with generic digital skills that can be utilised across a range of sectors, also promoting industrial diversification along the smart specialization strategy (Balland et al. 2019). **The RSA calls for integration of skills policy – both FE and HE – and the attraction of FDI.**

How does the Government's Investment Strategy relate to its Industrial Strategy, its regional policy and the "levelling up" agenda?

11. **FDI has a positive and significant impact on local economies.** Academic evidence shows that FDI can lead to significant benefits in the local economies in which it takes place. Moreover, the benefits extend beyond the initial FDI, and other firms in the same local economy benefit from 'spill-overs' as they learn from foreign owned firms or benefit from the supply chains they create (Driffield et al., 2010). Also, FDI generates local multipliers also in terms of local employment generation over and above the new jobs directly created by the new establishment. These positive employment effects diffuse to the benefit of multiple sectors employing skills similar (related) to those typical of the original investment (Cortinovis et al. 2020).

12. **Inward investment plays an important role in levelling up.** But to do so it must build on the industrial and skills base of the local economy. Achieving this involves good

governance and relations between local stakeholders/policy-makers and inward investors - particularly in steering skills and investment programmes. A critical adjunct is a strong devolved skills policy which 'has teeth' to enable transformations.

13. **Inward investment is not about a 'race to the bottom' in terms of labour rights or wages.** The UK can never compete simply on the basis of low prices. High value FDI tends to be focused on skills (Becker et al., 2020). Enhancing life-long skills - particularly in digital - will be critical if the UK wishes to be globally competitive. Tailoring skills programmes to local industrial bases (through SAPs) will play an important role in 'levelling up'. The RSA urges government to adopt a 'high road' approach to inward investment based on skills and R&D.

14. In this context however there is a further risk, as explored in detail in a recent ESRC funded project on institutions, policy and inclusivity (LIPSIT.ac.uk). Inward investment policy has been synonymous with regional policy since the early 1990s, with the attraction of internationally mobile capital being a crucial element of regional development or "levelling up". However, we run the risk of inward investment increasing rather than reducing spatial inequality post COVID. As the economy recovers, local agencies such as Local Enterprise Partnerships (LEPs) have employment targets, and those LEPs covering lagging regions may feel pressured into securing "any jobs". Thus, potential investors will seek to locate low value-added activities in these locations, linked to local labour market conditions. As such, lagging localities will be pushed into a "low skill equilibrium" linked to flexible labour markets and insecure employment, while better performing regions will attract more high tech investment. The levelling up agenda has to be concerned with breaking this cycle.

15. **While the attraction of new FDI is important, the government needs to consider how policy can retain existing FDI**. This is particularly important in the context of Brexit. Working on the retention of existing FDI means a wider mandate for regional IPAs and LEPs that should reinforce their after-care services and maintain close links with foreign investors to ensure a smooth running of their operations at all times (World Bank, 2020). In addition, active interventions (in particular in less advanced regions) are necessary to support local linkages with domestic firms (suppliers) and more generally the overall investment eco-system.

16. **Finally, a levelling-up agenda cannot be pursued by looking at inward investment strategies in isolation.** Inwards FDI should be considered as part of a much wider internationalisation strategy of regions, using industrial strategy to help linking up to

Global Value Chains in a more holistic manner that also involves outward FDI and internationalisation of UK domestic firms, in order to fully reap the benefits of globalisation in terms of productivity growth, increasing wages, diversification and knowledge transfer (Crescenzi and Harman, 2018).

What advice, support and assistance should the Government be providing to inward investors – and how can it most effectively communicate with investors?

17. **The UKs value proposition to inward investors is changing.** As such it is crucial that the government has a consistent message on this, and does not seek to manage its relationship with its leading inward investors through individual packages of support and the use of Non-Disclosure Agreements. Clarity is vital here, not just in terms of the message, but also the modes of communication. It will be critical to encourage inward investors to work closely with local stakeholders (e.g., Combined Authorities/LEPS/business associations/chambers of commerce) on the investment and skills programme, and more generally the wider delivery of local industrial strategies. This can facilitate greater embeddedness and a better understanding of a region's needs and possible future trajectory. This may facilitate success, future investment, and retention.

What effects would the provisions of the National Security and Investment Bill have on UK inward investment – and how well does it balance national security against promoting and facilitating inward investment?

18. This falls outside of the remit of the RSA.

What role do Sovereign Wealth Funds play in UK inward investment – and how might that role develop?

19. The UK's value proposition to inward investors is going to change as the relationship with the EU changes. At the same time, in the post COVID world, assets globally are likely to be cheap, and Sovereign Wealth Funds (SWFs) are likely to be looking for better returns on their investment. The UK is, in the near to medium term, investing in various infrastructure projects linked to both transport and energy that may well attract the attention of SWFs.

What particular issues do Sovereign Wealth Funds pose in respect of UK national security – and how can these most effectively be addressed?

20. This we assume is referencing the possibility of SWFs either becoming more involved in our energy sector or purchasing stakes in high tech companies with applications linked to defence. In general, the UK has a more relaxed position concerning these investments than any other developed economy, and so one can see why the question is being asked, but one could really only answer this on a case-by-case basis.

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