26th February 2021

Global Infrastructure Investor Association

House of Commons International Trade Select Committee

Inward Foreign Direct Investment Inquiry Submission

1. About GIIA

1.1. Global Infrastructure Investor Association (GIIA) is the membership body for the world's leading investors in infrastructure, and advisors to the sector, who collectively represent nearly US$1 trillion of infrastructure assets under management across 55 countries. Our members are investing today to provide the smart, sustainable and innovative infrastructure needed for our communities and economies to thrive. The investor member base of GIIA is diverse and ranges from fund managers, pension funds, insurers and sovereign wealth funds (a list of GIIA members can be found at http://giia.net/membership). We are therefore well placed to provide the committee with the views of the global infrastructure investor community.

1.2. In the UK, GIIA members are responsible for:

a. Major investments in 17 of the UK's 20 airports, which account for 94.4% of total passengers.
b. Supporting almost 120,000 jobs in the nation's privately owned ports.
c. Supplying 2/3 of UK household's water needs.
d. Providing an additional 14 million households with full fibre internet while continuing to invest in 5G technology.
e. Producing 32% of the UK's entire renewable energy capacity.

1.3. In addition to this significant source of foreign direct investment (FDI) that boosts the UK economy, our research shows that more than 8.5 million UK pension pots are invested in UK national infrastructure, helping to deliver a stable return for UK citizens in their retirement. In transport, renewables, digital and social infrastructure, GIIA members are investing across the country to deliver the infrastructure needs of UK citizens, sustaining hundreds of thousands of jobs and supporting the wider economy.

1.4. To illustrate this visually, GIIA has developed a video animation on UK pension infrastructure investment, available here: https://vimeo.com/428270182/a3308b8060

2. Private investment in infrastructure and Foreign Direct Investment

2.1. Studies have shown that those countries with high-performing physical and digital infrastructure receive higher levels of FDI than their counterparts with lower quality infrastructure[1]. Infrastructure investment stimulates long-term sustainable growth, increases the number of jobs in the economy and returns multiples of the original investment by growing GDP. The Boston Consulting Group estimates that every $1tn invested into infrastructure has the potential to create over 3 million jobs in the

[1] Conference: 2nd International Osmaneli Social Sciences Congress (2016), URL

span of five years[2] and, according to the Washington-based Economic Policy Institute, infrastructure investment has an output multiplier of 1.57, meaning that every $1 spent on infrastructure returns $1.57 in GDP[3].

2.2. Over US$3.7tn of investment a year is required in economic infrastructure to 2035 to bridge the gap between current investment levels and the needs of society (the infrastructure gap), according to the McKinsey Global Institute[4]. Oxford Economics forecasts a cumulative shortfall in infrastructure investment of $15tn (£11.9bn) between 2016 and 2040[5]. The UK Government's Infrastructure Finance Review also states that over the next 10 years, around half of the £600bn infrastructure pipeline is forecast to come from the private sector through electricity networks, digital, airports, and water & waste[6]. The scale of financing required highlights the critical role that private investment must play if this gap is to be filled and FDI will play a fundamental role in delivering this.

2.3. The UK has a strong track record in attracting FDI to UK infrastructure assets. In particular, the UK's system of economic regulation over the past 30 years following privatisation has brought significant benefits to the economy and broader society and has acted as a catalyst for investment. Many of the challenges that were experienced during public ownership – such as gold-plating – have been addressed, with the networks industries consistently outperforming the rest of the economy in productivity measures.

2.4. Because of this, around £150bn has been invested in water networks since privatisation – almost double pre-privatisation levels – and £45bn was invested in energy networks and generation between 2010-13 alone[7]. This investment has delivered tangible economic benefits right across the UK and laid the groundwork for a modern, digital economy.

2.5. However, total foreign direct investment (FDI) levels into the UK have been on a downward trend for several years. The House of Commons Library shows that in 2019, FDI had fallen for the third year in a row, having peaked at £192.6bn in 2016, to £35.6bn in 2019[8]. Global flows of FDI increased by an average of 3% over the same time period to $1.5tn in 2019, demonstrating the pace with which the UK has fallen behind competitors in the race for global capital investment[9].

2.6. A number of factors, including the combination of the perceived politicisation of economic regulators in recent years, increased levels of risk as a result of the UK's decision to leave the EU in 2016, and the threat of re-nationalisation from the HM opposition have all served to undermine confidence in the UK and damaged sentiment towards the attractiveness of the UK as an investment destination. The impact of the Covid-19 pandemic has only served to exacerbate the trend. The EY UK attractiveness survey 2020, estimates that changes in investment intentions due to the pandemic and the associated Government response are likely to translate into a fall of 30%–45% in UK FDI project numbers in 2020 compared to 2019[10].

[2] Boston Consulting Group, a jobs-centric approach to infrastructure investment, (2017), URL
[3] Economic Policy Institute, the potential macroeconomic benefits from increasing infrastructure investment, (2017), URL
[4] McKinsey Global Institute, bridging infrastructure gaps (2017), URL
[5] Oxford Economics, global infrastructure outlook (2017), URL
[6] HMG Infrastructure Finance Review (2019), URL
[7] GIIA Future of Regulation (2020), URL
[8] House of Commons Library, FDI statistics, (December 2020), URL
[9] Ibid
[10] EY UK attractiveness survey (2020), URL

2.7. Alongside this, there is a question mark for investors hanging over the Government's intentions on funding models for infrastructure investment. At Budget 2018 the then Chancellor announced that the UK Government would cease using the Private Finance Initiative and PFI2 models, without taking steps to identify a suitable preferred model for private infrastructure investment to take its place. Investors are unclear on the funding models that the Government favours to leverage private capital, and question the decision to move away from the PFI/PPP model that is so widely used successfully elsewhere in the world[11].

2.8. Alongside this, GIIA research shows that only 29% of UK citizens are satisfied with the UK's national infrastructure, while 80% agree that infrastructure is vital to future economic growth, and 66% feel that the UK is not doing enough to meet its infrastructure needs[12]. There is a clear need for investment in new and upgraded high quality infrastructure, and the scale of the investment required cannot be delivered by the public sector alone.

3. Role of the regulatory regime in enabling inward FDI

3.1. To attract FDI, the Government should also pay due regard to the ways in which regulatory measures can affect FDI inflows by impacting the near-term perception of the UK as an attractive destination for inward investment. For example, in the utilities sectors, recent regulatory determinations have proposed significant cuts to the return that an investor can earn, with little direct impact on customer bills, whilst increasing the risk profile of regulated companies. Over time, regulatory changes that increase revenue volatility and risk exposure will increase the cost of capital, which may reduce appetite for inward investment.

3.2. Specifically, recent regulatory price determinations in the utilities sectors have placed too great an emphasis on short-term affordability to the detriment of longer-term sustainable investment objectives whilst undermining the ability of utility companies to deliver the performance improvements and investments their customers have signalled that they wish to see.

3.3. Regulators have become overly concerned with areas that had hitherto fallen squarely within the remit of independent company decision making (such as around gearing and CapX) and so the measures have represented a departure from the established regulatory principle – common across all UK regulators – that regulated private companies are free to determine their own capital structures. The determinations have therefore adversely affected the perception of the independence of the regulator, with regard to the day-to-day management of its regulated entities, in the eyes of institutional investors.

3.4. The price determinations have also served to penalise investors by introducing hindsight to the assessment of the cost of debt, a position which is not reflective of the regulatory guidance of the day when those long-term financial decisions were made, nor is it consistent with the principles of better regulation. The cumulative impact of these changes has had a material impact on the way in which overseas investors now view the investment opportunity in the UK, not just in UK utilities but more broadly in other sectors too.

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[11] Infrastructure Partnerships Australia research, URL

[12] GIIA, Global Infrastructure Index, (2019) URL

3.5. The EY UK Attractiveness Survey 2020 also supports this position. It finds that only 5% of investors surveyed believe that Energy and Utilities will drive growth in the UK after the pandemic, compared with 20% of investors who think that Energy and Utilities will drive growth in Europe[13]. GIIA's Infrastructure Pulse Survey for Q1 2021 also finds that, of the major European geographies, only the UK and Ireland were less positive from the investor perspective than the prior survey in Q4 2020[14]. This was partly related to the signals sent by the CMA in its revised position on the ongoing water price redetermination in January 2021.

3.6. Notwithstanding this, GIIA welcomes the commitments within the National Infrastructure Strategy, released at Spending Review 2020, that the Government is committed to the model of independent economic regulation with refinements made to provide a clear and enduring framework for investors and businesses to deliver the investment needed in the decades to come, whilst simultaneously continuing to deliver fair outcomes for consumers.

3.7. However, whilst we welcome this commitment, we are yet to see evidence of the Government's position being translated into meaningful actions by UK economic regulators. We would therefore encourage the Government to expedite their thinking in this area and to publish the upcoming Regulation Policy Paper as soon as possible which should focus on the need for clear and consistent strategic advice to regulators in core sectors such as energy, water and digital.

4. National Security and Investment Bill

4.1. GIIA agrees with the principles underpinning the National Security and Investment Bill in terms of identifying and responding to possible national security threats. However, we would like to draw the Committee's attention to the following concerns which are related to FDI:

4.2. **Sector definitions**: The envisaged scope of the mandatory regime is currently very wide. Most of the 17 sectors are broadly defined, and there are no turnover or (in many cases) other size thresholds. As is clear from the Government's Impact Assessment, the Government understands that this, together with associated voluntary notifications, will result in a very large number of notifications, the vast majority of which are not expected to raise any national security issues whatsoever[15]. This raises serious questions as to whether the Government is casting the net too widely, given its stated goal not to deter foreign inward investment.

4.3. **Resourcing and timing**: Even if the breadth of the mandatory regime is reduced, it will be of vital importance that the Government has a sufficient number of highly-trained personnel to efficiently manage the large volume of notifications within the envisaged 30 working day initial screening period. Indeed, given its goal not to deter foreign investment into the UK, it should be the Government's firm objective to take significantly less than the full 30 working day period to clear the vast majority of cases.

4.4. **Streamlining the system**: GIIA believes that the creation of exemptions for institutional investors with a strong track record of responsible investment into UK infrastructure assets would provide significant additional clarity and reassurance.

[13] EY UK attractiveness survey (2020), URL
[14] GIIA Q1 Infrastructure Pulse Survey (2021), URL
[15] the Impact Assessment suggests that only 5-10% of notifications will require an in-depth national security assessment and less than 1% will be subjected to remedies.

This exemption system could be established by way of a certification regime, perhaps supported by an annual attestation to be completed by those investors to confirm each year that they continue to qualify for the exemption.

4.5. **Call-in powers**: The ability for the Government to act retrospectively by 'calling in' deals up to 5 years after completion could impose significant risks for investors and could negatively impact incentives to invest in the UK. Accordingly, this power should be exercised sparingly and only in extreme cases.

5. Sovereign Wealth Funds and FDI

5.1. As outlined earlier in this submission, the UK suffers from a growing infrastructure gap, exacerbated by the effects of the pandemic which have further reduced both investor sentiment and overall FDI flows. Alongside this, the UK has enshrined in law a commitment to deliver net zero emissions by 2050, which will require significant investment by businesses and Government to be achieved.

5.2. Research produced by PwC in partnership with GIIA estimates that £400bn of investment is needed over the next ten years to achieve the UK's net zero objectives[16]. This represents nearly a doubling of capital requirements, based on the UK's Infrastructure Delivery Plan, which in 2019 called for more than £20bn of annual private investment in Real Assets sectors such as energy, water and telecoms. With Government finances stretched to record levels, private capital will be vital to achieving the level of investment required to revolutionise UK infrastructure in power systems, buildings and industry, transport, and digital sectors.

5.3. The growing pool of capital held by Sovereign Wealth Funds (SWFs) around the world potentially forms part of the solution to bridging the UK's widening infrastructure gap. SWFs have generally aligned more closely with projects which have very long-term investment timeframes, in contrast to the strategy of many other types of investment vehicle. This is often the case with infrastructure projects, which may take years to complete and decades to produce a break-even return. For SWFs and other sovereign investors, the timeframes associated with such investments do not pose a deterrent, as SWFs typically do not have express liabilities that would limit their ability to invest in long-term, illiquid assets like infrastructure projects. Preqin, the asset management data provider, tracks 66 SWFs with disclosed assets under management (AUM) of $8.59tn, which is equal to 9.7% of the more than US$88.7tn in total AUM worldwide[17].

5.4. It is worth stating that SWFs will be subject to the same measures outlined within the National Security and Investment regime as any other foreign investors in the UK. GIIA believes that the national security regime should be the primary means by which investments that potentially pose a threat to national security are identified and remedial action taken as necessary. There should not be any additional restrictions placed on investment from SWFs, or else the UK risks losing out to competitors in the race for the significant pools of capital under management by SWFs.

5.5. Further, in GIIA's experience, investment decisions taken by SWFs have been independently reached by investment professionals sitting within investment committees, with little or no outside interference from state or political actors, making

[16] PwC, unlocking capital for net zero Infrastructure (2021), URL
[17] Preqin, sovereign wealth funds, worlds in motion (2020), URL

them, in many cases, no different to other institutional investors in terms of their outlook and investment activities.

6. HM opposition re-nationalisation policy

6.1. The final point that GIIA makes in this submission relates to evidence provided to the Minister of State for Investment, Lord Grimstone of Boscobel Kt, via the Investable Infrastructure Senior Leadership Group. GIIA has made clear that the threat of re-nationalisation from the official HM opposition in recent years has undermined confidence and damaged sentiment towards the UK as an attractive investment destination.

6.2. The threat of re-nationalisation of privatised industries has the potential to act as a significant deterrent against existing and future FDI. Independent estimates suggest that the upfront cost of re-nationalisation of utilities to the Exchequer alone would be at least £176bn. This represents around 10 per cent of the UK's national debt or £6,471 for every household[18].

6.3. The public control of assets and shares from investors in various industries would dampen business confidence – especially if the compensation was below the commercial value. This would encourage capital flight, reduce overall levels of FDI and reduce business investment to even lower levels than is currently the case.

6.4. In terms of meeting the Labour Party's commitments to UK business and encouraging FDI, GIIA would emphasise that the party should actively seek to effect reforms that they believe are necessary to the existing policy and regulatory framework, rather than pursuing a policy of re-nationalisation. GIIA believes that a re-nationalisation policy would have a profound and long-lasting negative effect on future inward investment and make any future Labour Government's plans to deliver low-carbon, climate-resilient infrastructure far more difficult to achieve.

7. Role of the Office for Investment

7.1. To succeed in the global race for capital, the UK needs to remain attractive for FDI. Getting the investment environment right will promote competition for investment opportunities, help drive value for money and increase overall levels of FDI. Given this, and the points made earlier in this submission, GIIA makes the following recommendations regarding the role of the newly established Office for Investment:

7.2. **The OfI should work with the Government to establish a clear pipeline of investable infrastructure projects** built on a detailed roadmap to achieving strategic policy objectives. This will provide clarity on investment opportunities in the UK, and, in turn, encourage competition. The recently released National Infrastructure Strategy gives a high-level view, but Government should now work with industry to provide further detail on specific actions and projects in each sector.

7.3. **The OfI should work with Regulators and the Government** to take specific steps to incentivise innovation over the long-term. This will ensure that companies align their work to improve service delivery and capability with long-term objectives which yield commercial outcomes. It would push back against recent approaches to regulation which have weakened incentives to innovate by focussing on short-term bill reductions at the expense of long-term investment. The OfI should work with arm's length bodies such as Innovate UK, and the catapult centres in this regard.

[18] Centre for Policy Studies, the cost of nationalisation (2018), URL

7.4. **The OfI should work with the Government to improve the procurement of PPPs** by streamlining processes and assessing value-for-money based on factors other than cost alone. This would increase competition and drive the roll out of assets by minimising delivery and reputational risk. This would also help 'crowd-in' private sector investment, achieving one of the objectives of the National Infrastructure Bank which is to be mandated at Budget 2021.

7.5. **OfI and Government should carefully consider the application of powers granted by the National Security and Investment Bill** which has the potential to act as a deterrent to investment in the UK (more information is provided under section 4 above).

8. Summary

8.1. The UK is facing a growing infrastructure investment gap, exacerbated by the pressures on the public finances with record Government borrowing throughout the pandemic to support the economy against a backdrop of strict coronavirus restrictions. At the same time, FDI levels for the preceding three years have decreased significantly, whilst rising in other countries. The Government and the new Office for Investment must prioritise the need to attract FDI to UK infrastructure assets to support the UK's recovery from the pandemic and boost economic growth.

8.2. This can only be achieved by ensuring that foreign investors in the UK have confidence in the UK's policy and regulatory framework, alongside a national security regime that is established in such a way as to encourage the free flow of investment. The UK should also be maximising the potential for investment from SWFs which are responsible for significant pools of capital to deploy and will be subject to the same national security regime as other investment vehicles.

8.3. The HM opposition should reconsider its approach to the re-nationalisation of regulated utilities, which would only serve to add additional pressures to the public balance sheet whilst reducing the productivity and value creation of these sectors for consumers and dampening the incentives to invest private capital.

9. Contact details

9.1. For more information about GIIA and the contents of this submission please contact John Kavanagh, Head of Policy and Public Affairs:

www.giia.net

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