British Embassy
Stockholm

Wilton Park

Report

UK-Nordic collaboration on post-COVID recovery: the impact of COVID-19 on Foreign Direct Investment (FDI) and supply chains

Friday 4 December 2020 | WP1854V2

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In association with the British Embassy in Stockholm

This virtual discussion explored how the UK and its Nordic partners can work collaboratively as champions of FDI and well-functioning supply chains and was held in association with the British Embassy in Stockholm as part of the three-part virtual series highlighting **'UK-Nordic Collaboration on post-COVID Recovery'**.

COVID-19 has highlighted significant weaknesses in the global trade and investment landscape, raising the urgent question of how the pandemic will continue to affect investment making and, in turn, affect global value chains. Each country has different arrangements relating to FDI and security and new EU rules may promote further convergence in the three Nordic EU countries. A key question for open, liberal, free-trading economies is how to maintain the free flow of trade and investment, whilst protecting national security and critical infrastructure, maintaining agility and flexibility in supply chains, and retaining constructive international relations.

Recommendations

1. The UK and Nordics share a like-minded, liberal approach to trade. Global trade tensions and the impact of Covid, as well as the UK's EU departure re-emphasise the need to continue to support each other on international trade issues including in relation to security, with China, and on WTO reform.
2. On-going exchanges between policy makers and business are essential in the consideration of proportionate investment screening mechanisms, and in recognising that resilient supply chains in different sectors (especially those critical to national security or health) may require different strategies. Further sharing of approaches between the UK and Nordic countries would be valuable.
3. The UK and Nordic nations need to identify how best to work together to optimise FDI as part of the Covid-19 recovery, with greater public and private sector cooperation and coordination, as well as how best to facilitate a more advantageous trade environment in the face of challenges to multilateralism.

4. This question is further compounded by the absence of a unified set of rules and guidelines on the screening of FDI across the EU, with the risk of inconsistent national decisions being made on which FDI is approved or blocked. Countries need to collaborate on building a unified and systematic governance structure to provide a transparent, consistently applied and easily understood model.

Headlines

5. International trade has become increasingly important, especially in the developing world. However, trends such as offshoring and fragmenting have created great uncertainty, exacerbated further by developments within global trade politics and the perceived move towards 'slowbalisation' i.e. continued integration of the global economy via trade, financial and other flows but at a significantly slower and less even pace.
6. Questions remain around the extent to which the incoming Biden administration will restore the United States to its pre-2016 position on international trade and how liberal free trade economies can maintain a free flow of trade and FDI without jeopardising national security and critical national infrastructure.
7. Resilience in supply chains is to a large extent a problem for business to resolve, unless there is a public dimension that might warrant government intervention. More understanding of critical supply chains would be helpful in determining and mitigating risk.

A global perspective

8. A key requirement for success is the provision of leadership. In the period 2005-2010, the EU was successful in leading the World Trade Organisation (WTO). China's membership altered the balance, and attempts between China, the EU and the US at trilateral leadership failed. The UK's departure from the EU (EU Exit) has created a new dynamic in terms of Europe's relationship with the WTO. In light of this, there is a need for cooperation between the EU, the United Kingdom and the US to jointly respond to Chinese interests and goals. It remains unclear how highly countries will prioritise action through the WTO and whether another organisation might be better placed to progress the 2030 agenda.
9. Notwithstanding the desire for a collaborative approach, the EU, the UK and the US will still compete in other areas. Therefore, there will be a considerable need for new frameworks and conventions to accommodate new realities such as the post EU Exit world and the new US administration.
10. Biden's past attitude to the WTO and the US' place on the international stage, as well as his more recent statements signalling similar sentiments, indicates that he will be dedicated to restoring global alliances and relationships. He has stated that he will restore the US to the position it had in the WTO prior to 2016. There is some cause for optimism that he will also enable and champion a Europe-US realignment.
11. There is a broader conversation to be had on whether EU and UK views on the WTO will diverge in the future. Recent Biden comments suggest that there seems to be little reason to feel optimistic about the resurrection of the Transatlantic Trade and Investment Partnership (TTIP) as the US will not enter any new trade agreement until they have made major domestic investments. However, there remains a distinct possibility of reinforced EU-US trade cooperation, which could serve as a foundation for future expanded regulatory cooperation, which had constituted the primary benefits of the TTIP.

Investment and security

12. The screening of FDI remains a sensitive and complicated issue that needs to achieve a balance between genuine commercial ventures on the one hand and strategic takeovers initiated by state actors on the other. Concerns include the safeguarding of what are deemed as critical elements of national infrastructure such as ports. Strategic takeovers also disrupt commercial balance; these companies receive state backing in the name of strategic interests that cannot be matched by the rest of the market. The challenge is to distinguish as clearly as possible between what is commercial and what is strategic.

13. To what degree is it prudent for national governments to block FDI in the name of national security interests? Conflicting interests may cause tension between the private and the public sector when it comes to determining the answer to this question.

14. It could be argued that government blocking of FDI is tantamount to state expropriation of shareholders' rights to sell their shares to a preferred buyer, as shareholders risk receiving a lower value for their assets than they might otherwise have achieved. However, there are already investment barriers in place within, for example, the defence sector, where there are regulations as to who might invest in such companies. Precedents therefore exist, meaning it remains unclear as to whether this might truly be expropriation in the legal sense.

15. This question is further compounded by the absence of a unified set of rules and guidelines on the screening of FDI across the EU, with the risk of inconsistent national decisions being made on which FDI is approved or blocked.

16. Governments could position themselves more readily to provide support for infrastructure projects that cannot be fully supported by private sector companies. However, even traditional economic activity has the potential to be used as a political lever. For instance, there is growing evidence of China using economic ties, including FDI, as a means of coercive economic diplomacy.

17. As China's presence increases, a key consideration is how best to gauge China's goals in global trade. Which Chinese investments are actually driven by the aim for strategic takeovers, and which are typical commercial activity? There is also the uncertainty of the extent to which Chinese owned companies compete on an even footing with the rest of the market. Are they, for example, granted beneficial access to the large Chinese market? While European economies on the whole do not appear to be threatened by Chinese strategic investments, individual businesses certainly do seem to be exposed to a more direct threat. Many companies appear to possess the knowledge about potential risks of establishing business with China or threats from IPR copying but still view engaging with China as both inevitable and necessary.

18. Taking AI (Artificial Intelligence) as an example, the Chinese are able to progress rapidly in this field as they have no legal barriers to relevant research. Other nations may understandably be wary of, for example, the surveillance aspects of AI, but there is need for a considered debate amongst European nations on how to become more innovative and competitive with this and other technologies.

19. What does Europe need to do in order to lead the technology areas in which it is the market leader? 5G is an example of a technology which Europe will be relying on heavily – losing the innovation leadership would pose an extreme risk to security. Yet leading stakeholders in Europe too often focus on 'doing the right thing', resulting in their often being too slow off the mark.

Resilience and supply chains

20. Key questions that need to be answered centre around how deeply supply chains have been impacted by the pandemic, how companies have managed these impacts, and what their long-term plans are for avoiding similar issues in the future.

21. The main problems generated are increased times for delivery, services and goods, the lack of as well as the increased prices of services and goods.

22. Stockpiling and both the diversification and increase in number of suppliers appear to be the preferred solutions amongst companies in response to limiting the future impact of pandemics. Reshoring is not a preferred option since the lockdowns and overall Covid-19 impact across the EU demonstrated that this would not have addressed the challenges faced.

23. Most companies were therefore able to resolve their pandemic-related issues fairly quickly as the character of the issues they encountered did not drastically differ from their normal day-to-day challenges. Issues such as EU Exit, sanctions on nations and companies, and similar political disruptions, however, constitute long term, more permanent impacts on the global markets.

24. There are inevitably costs in establishing resilience. Trade-offs will always exist as the specific nature of upcoming challenges is naturally hard to determine in advance and establishing resilience against every possible future eventuality is prohibitively impractical from a business point of view. Appropriate resilience consists of spreading risks and avoiding placing “all eggs in one basket”. Measures such as stockpiling for short term self-reliance and mothballing industry facilities in preparation for future shocks are practical measures, whereas complete self-reliance is not.

25. Resilience can also be achieved by increased collaboration ahead of the next crisis to ensure that the impact to regional and global trade is kept to a minimum. As the National Board of Trade Sweden demonstrated in its recent report on ‘Improving Economic Resilience Through Trade’, it is important to ensure that existing supply chains continue to function in order to reach a sufficient degree of national resilience.

26. There is a lack of political control over international markets, but governments can still play an important role in helping resolve politically motivated trade problems that impact on them. Differing interpretations of government directives are one area that can be addressed by clearer directives to create more predictable markets. A proactive industry-political dialogue can contribute to preventing legislative or protectionist obstacles to international markets. Self-sufficiency is not a realistic alternative for many countries, which instead rely on international markets.

27. The impracticality of establishing comprehensive, resilient backup supply chains in preparation for the next shock further illustrates the need for governments to help maintain the free flow of trade. Even smaller resilience measures such as stockpiling represent a liquidity problem for smaller companies. Governments could assist in this aspect by providing the economic backing necessary to establish emergency stockpiles.

Wilton Park
February 2021

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