Attracting foreign direct investment to Northern Ireland in the context of our post EU exit trading relationships

Department for the Economy

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Summary

Northern Ireland has a strong track record in attracting high quality Foreign Direct Investment. A research project was undertaken to understand the potential impact of the post EU exit trading relationships on FDI into NI. A Strategic Framework was produced to analyse the impact of the UK - EU Trade and Cooperation Agreement and NI Protocol on FDI. While there are likely to be some winners and losers, the research does not draw a firm conclusion on the net impact of the new trading relationships. Instead, it points to the complex decisions that individual investors will need to make about how and where to invest in the current context. Overall, the research found that FDI into NI is expected to grow over the period 2021 to 2025.

Introduction

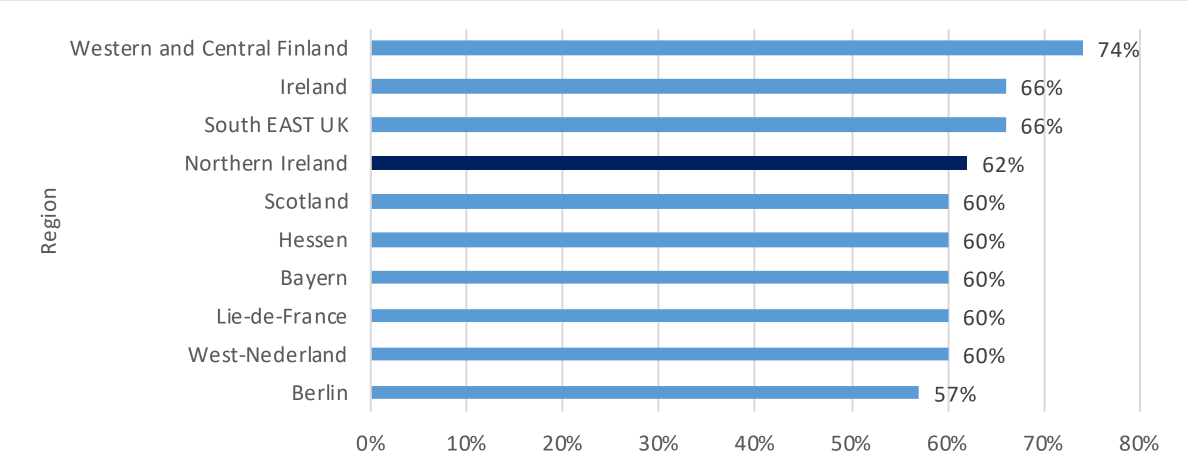
This paper provides a short summary of DfE commissioned research[i] conducted by Wavteq[ii] to examine the impact of the post EU exit trading relationships on Foreign Direct Investment (FDI) in Northern Ireland. Northern Ireland has been successful in attracting high quality FDI[iii] and continuing to do so will be an important part of delivering on the Department's 10X Economic Vision. The paper presents the research and analysis in terms of:

- The past performance of FDI in Northern Ireland in 2015-2020
- An assessment of the EU - UK Trade and Cooperation Agreement and the NI Protocol on FDI
- Forecasts for FDI in Northern Ireland for 2021-2025

The past performance of FDI in Northern Ireland in 2015-2020

Northern Ireland's competitiveness in FDI was compared against regions and cities across Europe. Northern Ireland has been successful in terms of attracting quality FDI and is ranked in 4th place in terms of the percentage of FDI in high tech sectors. (See Figure 1).

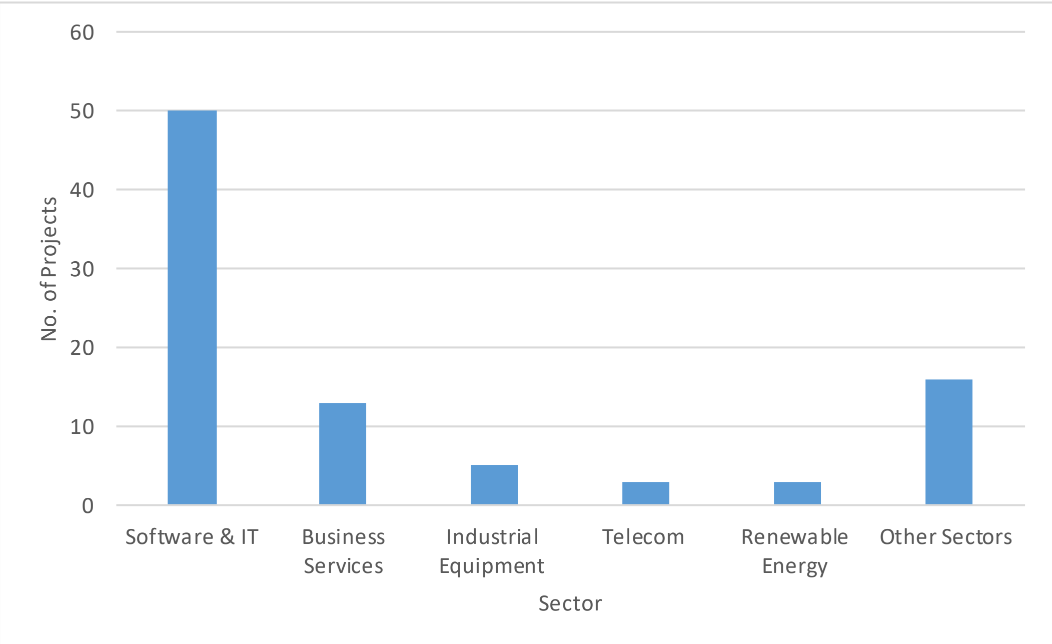
Figure 1: Ranking of regions in Europe with highest concentration of high tech FDI



Source: Wavteq. Graphs shows % of FDI projects which are high tech (2015-July 2020)

In terms of employment, around 50% of jobs created in NI are high tech, compared to 66% in ROI, 47% in Scotland, 37% in Wales and 25% in NW England. The research found that NI has a strong cost advantage compared to Western Europe locations and a high degree of specialisation in several sectors including life sciences, industrial equipment and aerospace. NI also has a very good track record in attracting FDI in software & IT and business services (see Figure 2). Across the UK Software & IT Services, Business Services and Financial Services were the top 3 sectors in attracting FDI for the period 2015-2019 and they are forecasted to be the top three sectors again in 2025.

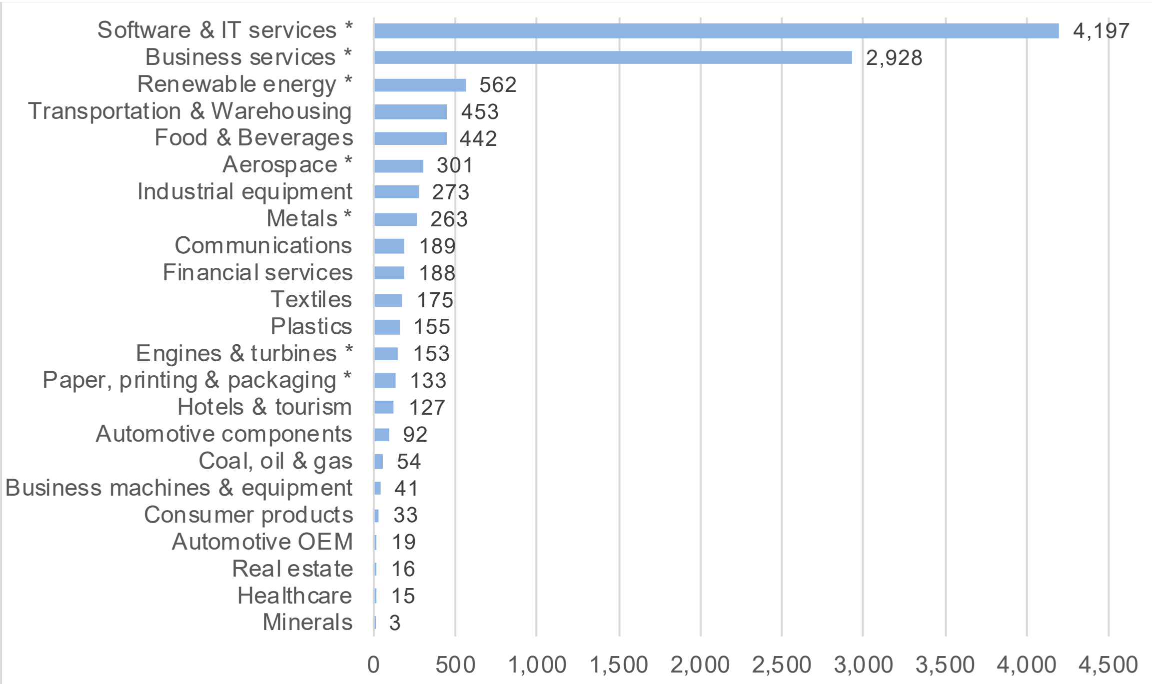
Figure 2: Top sectors for FDI projects in NI (2019-July 2021)



Source: fDi Markets, Financial Times. *Excludes retail projects*

A revealed comparative advantage (RCA) analysis of FDI was undertaken to identify sectors where Northern Ireland has a comparative advantage in attracting FDI projects and jobs. Northern Ireland has a RCA for both FDI *projects* and FDI *jobs* in Software & IT services; Business services; Renewable energy; Aerospace; Metals; Engines & turbines; and Paper, printing & packaging. Figure 3 shows the volume of FDI jobs by sector in NI from January 2015 - August 2020.

Figure 3: Top sectors for volume of FDI Greenfield jobs in Northern Ireland (Jan 2015-Aug 2020)



Source: Wavteq, fDi Markets

Notes: * sectors with an RCA in Northern Ireland

An Assessment of the UK - EU Trade and Cooperation Agreement and the NI Protocol on FDI

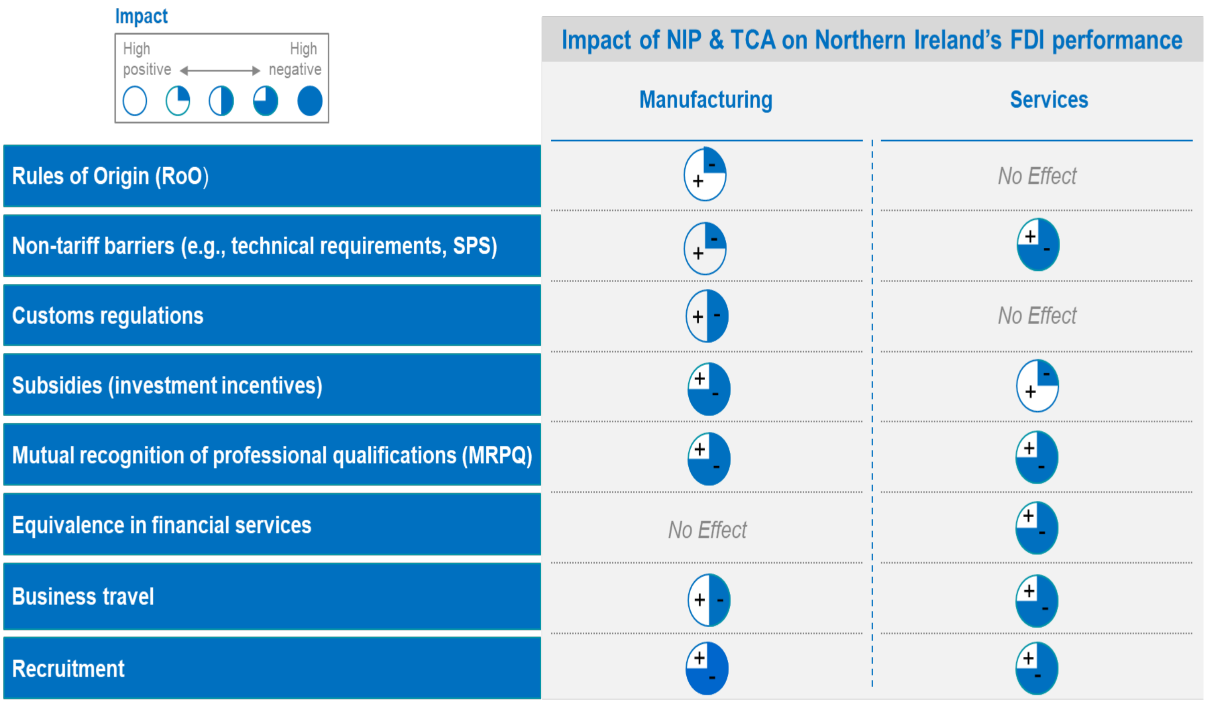
The UK - EU Trade and Cooperation Agreement (TCA) governs the trade relationship between the EU and UK after EU exit. It provides for zero tariffs and zero quotas on goods traded between the EU and UK that comply with the appropriate rules of origin. The provisions of the TCA on trade in goods do not cover trade between NI and the EU. This is covered by the Northern Ireland Protocol (NIP) which applies to NI - GB and NI - EU trade. It maintains an open border between Northern Ireland and the Republic of Ireland (and in effect the EU) for goods trade and maintains NI within the UK customs territory[iv].

Strategic Framework to measure impact of TCA and NIP on FDI in Northern Ireland

A Strategic Framework was produced to analyse the impact of the TCA and NI Protocol on FDI in Northern Ireland. The framework is based on eight major strategic impact areas which are each likely to impact both

FDI and domestic direct investment (DDI) in the UK and NI. The framework is illustrated in Figure 4 and it shows the impact on manufacturing and services sectors. In all areas there is a combination of positive and negative impacts.

Figure 4: Assessment on the impact of TCA and Protocol on NI's FDI performance



Source: Wavteq

A short overview of the potential impacts by area is provided in the following section.

- **Rules of Origin (RoO)**: NI could be more attractive for FDI because investing in NI companies can reduce exposure to RoO requirements for trade with both GB and EU due to NI's market access to each territory. However, NI producers will need to ensure GB suppliers meet RoO requirements for exports to the EU.

- **Non-tariff barriers:** NI-based manufactured goods will be regarded as complying with both EU and UK regulations which may increase attractiveness for FDI for some businesses.

- **Customs Regulations**: GB based companies face more administrative paperwork, costs, and delays for exporting from GB to EU and for trade between GB and NI. Companies in NI face no customs requirement or checks for exporting goods to the EU. Therefore, NI could be more attractive for FDI than GB as the EU is an important export market. This will depend on the volume of inputs and administrative costs associated with purchasing inputs via GB supply chains. NI goods producers are at a disadvantage compared to GB where significant supply chains are in GB.

- **Subsidies[v]:** The UK Subsidy Control Bill[vi] potentially offers more flexibility for the UK to offer more tailored and attractive government support than the EU, however trade in goods between NI and the EU including NI manufactured goods and goods distributed from NI will remain subject to EU state aid rules. NI (and GB) could offer greater and more tailored government support to services investors than the EU making NI more competitive for FDI compared to EU locations. If GB locations offer more attractive subsidies for goods producers than the EU, NI may find itself at a disadvantage in attracting FDI in this area.

- **Mutual Recognition of Professional Qualifications:** There is no mutual recognition of professional qualifications (MRPQ) in the TCA. The number of FDI projects may increase into the UK as companies can no longer easily serve the UK from the EU, however the EU could become more attractive than the UK as a sole destination due to the ability to serve a bigger market with reduced MRPQ issues.

- **Equivalence in financial services:** The TCA does not include any provisions on equivalence or regulatory cooperation in financial services. Therefore, equity trading FDI in the UK is expected to decline, and FDI in derivatives, foreign exchange and fintech are also expected to be lower. However, NI may be more attractive for supporting functions due its geographic proximity should Financial Services operations shift from London to Dublin.

- **Business travel:** Citizens of the UK and EU may no longer travel between the territories to do paid work without requiring a work visa for most activities. FDI in NI could increase if EU companies need to have a new base to provide services in the UK. However, project size could decline as investors establish smaller operations in both the EU and UK due to business travel and other EU exit related restrictions reducing the feasibility of centralising operations in a regional hub.

- **Recruitment:** Previously the UK had access to the EU labour market. Now work and residency visas will be needed for (non-Irish) EU citizens to move to the UK. The EU could increase its attractiveness for FDI given its larger labour market, and the additional costs and restrictions associated with UK work visas.

FDI forecasts for Northern Ireland for 2021-2025

Northern Ireland has been one of the best performing regions of Europe in attracting FDI in high technology sectors and is expected to continue to achieve growth in FDI due to its specialisation in large and fast growing segments of the FDI market (e.g. Software and IT). As already noted NI has maintained access to the EU single market for goods and, at the same time, remains in the UK customs union. A foreign investor setting-up in Northern Ireland can continue to trade with both the EU and UK without additional checks. However, there are now customs checks on goods travelling from GB to NI and it is a key source for NI supply chains.

NI is expected to achieve continued success in attracting FDI in high tech sectors. For manufacturing sectors the picture is more mixed with the post EU exit trading conditions potentially suiting some FDI businesses but not suiting others depending on their individual business dynamics.

The research forecasts that over the period 2021-25, Northern Ireland could attract on average 41 FDI projects per annum, which is a 20% increase over the previous five years. In turn just over 2,000 FDI jobs could be created per annum (an 8% increase over the same period). Approximately, half of the FDI projects and three-fifths of the jobs are expected to come from the new investors with the remaining projects and jobs from existing foreign investors.

Alignment with the 10X Vision

The research is well aligned to the Department's 10X Economic Vision and FDI has the potential to strongly contribute to the strategy's objectives. Digital, ICT and creative industries represent the strongest opportunity for FDI. The software & IT sector is forecast to remain the largest sector for FDI projects in the UK and globally in 2025. Over 50% of FDI projects and FDI jobs in Northern Ireland are in the ICT sector, and NI has built a strong track record in the fastest growing sub-sectors within ICT, in particular cybersecurity, where rapid growth is forecast.

How can this be achieved?

To achieve the growth potential for FDI, the research recommends that the NI Executive should continue promoting NI for FDI and build on current and past success with a sharper focus on target markets and priority clusters and technologies. A strengthened presence in established markets and diversification into new overseas markets is also important. A further recommendation is to innovate the NI FDI strategy to include a clear programme of promotional activities and support services for remote/hybrid working and develop a comprehensive talent attraction and skills strategy with talent being a key driver of FDI for both new and existing investors. Securing expansion projects from existing investors will also have an important role in the FDI strategy.

Conclusion

The research indicates that FDI into NI is expected to grow over the period 2021 to 2025, particularly in the Software and IT sector, where NI has a revealed comparative advantage and track record for success. The research does not draw a firm conclusion on the net impact of the new trading relationships resulting from EU exit, rather it points to the complex decisions that individual investors will need to weigh up as they make decisions about how and where to invest in the current context.

The overall impact of our new trading relationships may be more positive for foreign investors seeking access to both the GB and EU markets with less regulatory obstacles to trade in goods. The overall impact may be less positive for NI based companies dependent on GB supply chains. Notwithstanding the new trading environment, the Wavteq work points to the many selling points NI has to investors and concludes that there are strong opportunities for sustained growth of FDI.

Analytical Services, DfE

For further information or queries please contact analyticalservices@economy-ni.gov.uk.

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[i] The research underpinning this work was undertaken largely in 2021 and therefore it might not take account of more recent changes to the economic context.

[ii] Wavteq is a consultancy firm that specialises in foreign direct investment. It is a leading provider of products and services to facilitate international investment, trade and tourism. Further details can be found here.

[iii] In this study high quality / value added FDI is defined as projects / jobs created in sectors which are high productivity; have high salaries; are in high technology sectors; and meet the sustainable development goals of Northern Ireland.

[iv] On 21 July 2021 the UK Government published its command paper on the NI Protocol that sets out its proposals to deliver significant changes to how the existing Protocol operates. At the time of writing the EU have proposed changes to the operation of the Protocol with the intention of reducing post-EU exit checks on goods and medicines arriving in NI from GB.

[v] In June 2021, the UK government published the Subsidy Control Bill which provides the framework for a new, UK-wide subsidy control regime. Northern Ireland continues to apply EU State aid rules to all subsidies to companies that are within the scope of trade governed by the NI Protocol. These are primarily companies that manufacture or trade goods with the EU.

[vi] The UK Subsidy Control Act received Royal Assent on 28th April 2022.