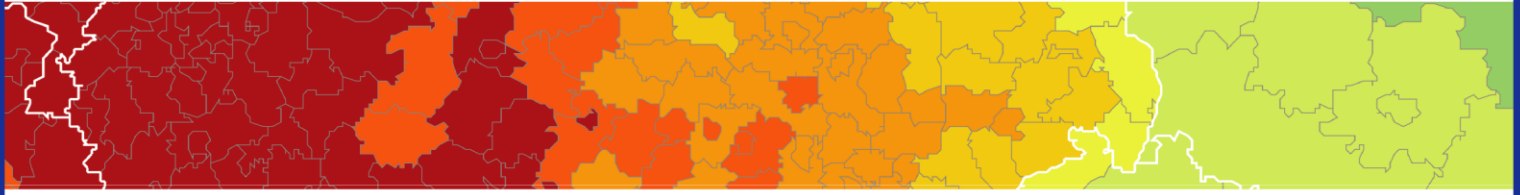


Inspire policy making by territorial evidence



# The World in Europe, global FDI flows towards Europe

## Extra-European FDI towards Europe

Applied Research

**Main Report**

March 2018

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The World in Europe,  
global FDI flows towards Europe

Extra-European  
FDI towards Europe



## Scope and introduction to the study

This report is part of the study, *The World in Europe, global FDI flows towards Europe*. The study casts new light on three topics related to the integration of Europe in the world economy:

1. Extra-European FDI towards Europe
2. Intra-European FDI
3. FDI by European SMEs

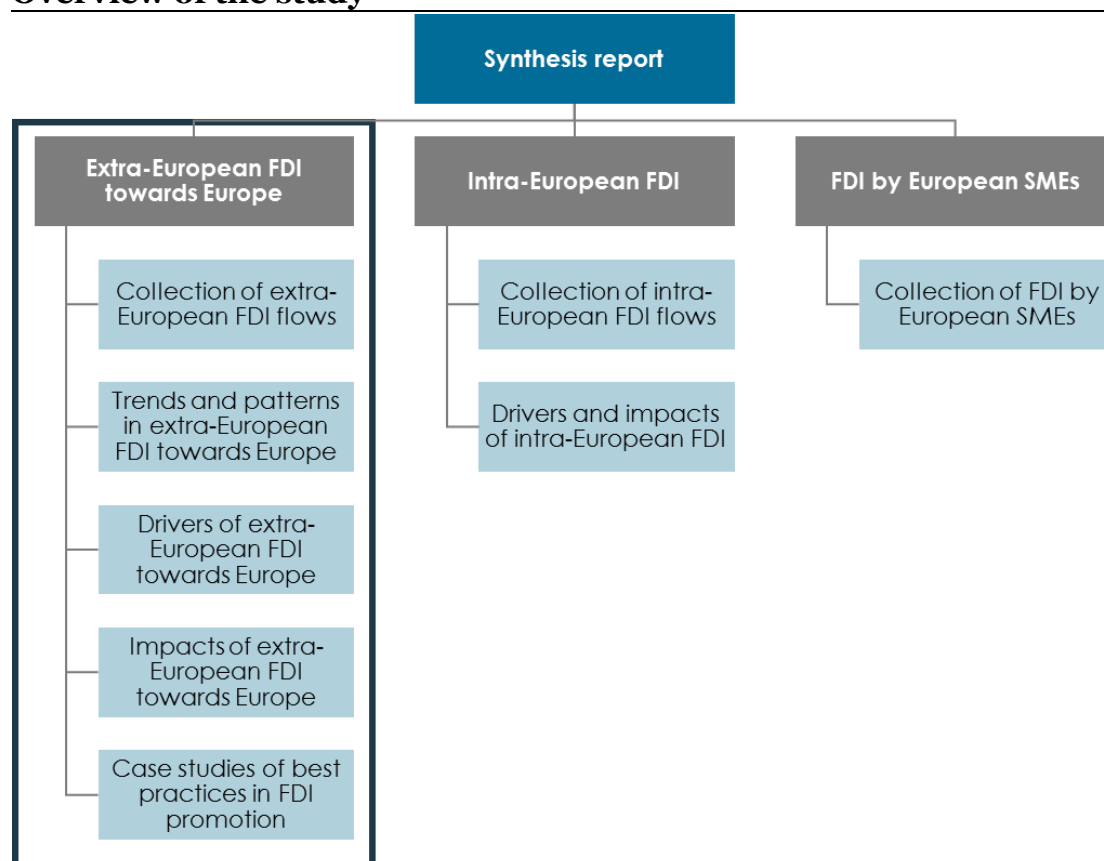
Key conclusions and recommendations related to each of these questions can be found in three stand-alone reports. Each report is supported by a number of scientific reports that contain detailed methodological descriptions and results. The insights gained from the study are summarised in a synthesis report that cuts across the three topics.

This stand-alone report analyses global FDI flows towards Europe (extra-European FDI). The insights gained in this report will be used to develop tailor-made policy recommendations that can help spur extra-European FDI into Europe. The conclusions and recommendations in this report are supported by five scientific reports.

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## Overview of the study

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The analysis of extra-European FDI towards Europe addresses the following key policy questions:

- What are the trends and patterns in extra-European FDI flows towards Europe?
- What is the relevance of extra-European FDI inflows for regional growth, competitiveness and convergence?
- What are the drivers of extra-European FDI inflows across European regions?
- What policy measures can be implemented to attract FDI towards Europe?

Throughout the report, we refer to extra-European FDI as FDI flows towards Europe by third country investors. We distinguish between two main types of FDI: Greenfield investments, and mergers and acquisitions (M&As). Greenfield investments take place when a new foreign firm establishes itself in the region and sets up new or expands existing production facilities. M&As take place when a foreign firm acquires more than 10 per cent of the voting stock in an existing domestic firm.

**Chapter 1** describes the trends and patterns in FDI inflows based on the unique database of FDI at a regional level that has been developed as part of this study. We use the following categories to analyse groups of regions with similar characteristics:

- The **rural-urban typology** from Eurostat
  - Rural regions:* Regions where the population in rural grid cells accounts for 50% or more of the total population.
  - Intermediate regions:* Regions where the population in rural grid cells accounts for a share between 20% and 50% of the total population.
  - Urban regions:* Regions where the population in rural grid cells accounts for less than 20% of the total population.
- The **metropolitan typology** from Eurostat
  - Capital metropolitan regions:* Regions that host the capital city.
  - Other metropolitan regions:* A single or a combination of NUTS3 regions, which cover agglomerations of at least 250,000 inhabitants across a city and its commuting zones.
  - Non-metropolitan regions:* All other regions.
- The **level of economic development**
  - More developed regions:* Regions where the average GDP per capita over the period 2010-2013 was more than 90 per cent of the EU28 average.
  - Transition regions:* Regions where the average GDP per capita over the period 2010-2013 was between 75 per cent and 90 per cent of the EU28 average.
  - Less developed regions:* Regions where the average GDP per capita over the period 2010-2013 was less than 75 per cent of the EU28 average.

**Chapter 2** analyses the impacts of FDI flows towards Europe. Here, we distinguish between 1) the direct impact of FDI in terms of the number of firms, job creation and value added in non-European owned firms located in Europe, and 2) the possible productivity spillovers on local firms that improve the competitiveness and economic growth prospects of European firms. We analyse both types of impacts for the different groups of regions in order to assess the impact of FDI inflows on economic convergence in Europe. Overall, FDI will tend to support convergence if it flows mainly to the less advantaged regions (such as rural, non-metropolitan and less developed regions) or if the impact of FDI in disadvantaged regions is larger than for more advantaged regions (such as urban, capital and more developed regions).

**Chapter 3** analyses the drivers of FDI flows towards Europe. We focus mainly on drivers that can be influenced by regional policy makers but address also drivers at the bilateral, EU and national levels. Finally, **Chapter 4** provides policy recommendations and offers inspiration to future research.





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## Abbreviations

BvD	Bureau van Dijk
EC	European Commission
ESPON	European Territorial Observatory Network
EU	European Union
FDI	Foreign Direct Investment
FT database	fDi Markets database offered by the Financial Times
M&A	Mergers and acquisitions
NUTS	Nomenclature of Territorial Units for Statistics



## Executive summary

As barriers to cross-border trade and investments have been dismantled during the past two decades, worldwide competition for attracting multinational firms has intensified. Investors have historically been attracted to the EU due to its large market size, the high degree of stability and the skilled labour force.<sup>1</sup> Before the crisis, the EU was the destination for almost half of the global FDI flows, but the EU share was only around 25 per cent in 2015.<sup>2</sup> An important driver for the shift in global FDI flows is the opening up of new emerging markets with high economic growth, light regulation and more active use of state aid than the EU.

Low growth prospects make Europe a less attractive location for FDI than the US or the BRIC countries, but much can still be done by European policy makers to reverse the downward trend in the share of global FDI. This study combines quantitative<sup>3</sup> and qualitative<sup>4</sup> analyses to convey new knowledge about how extra-European FDI is distributed across European regions, the underlying FDI drivers and the impact of FDI on the regional economies. We have used the insights obtained from this study to develop new policy initiatives that can stimulate FDI inflows into Europe and increase benefits from FDI inflows. Eventually, such policy initiatives can stimulate regional growth, competitiveness and convergence in Europe.

### **FDI inflows support regional growth and competitiveness but limited convergence**

The findings in this report are based on a unique and very detailed database on FDI inflows for NUTS3 regions in Europe, which we have built as a part of this project. In building this database, we have combined several data sources and carried out thorough cleaning and quality assurance procedures.<sup>5</sup> During 2003-2015, non-European investors carried out more than 52,000 FDI projects in Europe amounting to a total value of more than EUR 2,600 billion. Almost 44,400 of these projects have been mapped at the NUTS3 level, and we have used this data

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<sup>1</sup> E&Y (2015), *EY's attractiveness survey: Europe 2015 – Comeback time.*<sup>2</sup> UNCTAD (2016), *World Investment Report 2016.*

<sup>2</sup> UNCTAD (2016), *World Investment Report 2016.*

<sup>3</sup> In the quantitative analyses carried out throughout this study, we have attempted to include as many European countries and regions as possible. However, data on FDI flows and drivers for the EU Candidate Countries (The former Yugoslav Republic of Macedonia, Turkey and Montenegro) and the other countries of the Western Balkans (Bosnia & Herzegovina, Serbia, Albania and Kosovo) are relatively scarce. Therefore, the conclusions and policy recommendations cannot be extended to these countries without further analysis.

<sup>4</sup> Seven case studies have been carried out to identify good practices in attracting FDI and integrating the attraction of foreign firms in regional and development strategies. The scientific report, *Case studies of best practices in FDI promotion*, offers a synthesis of the findings from the case studies and a detailed description of some of the initiatives that respondents have identified as best practices.

<sup>5</sup> The methodology used to collect the data has been described in more details in the scientific report, *Collection of extra-European FDI inflows towards Europe.*

to analyse the distribution and composition of extra-European FDI across European regions. Some of the key findings of relevance for policy makers have been summarised below.<sup>6</sup>

**Figure 1 Overview of regional FDI drivers**

	Regional drivers	Impact	Significant for...
Policy FDI drivers	Strength of industry clusters	+	All regions, but especially important for intermediate and rural regions, other metropolitan regions and less developed regions
	Labour abundance	+	All regions, but especially important for urban regions, capital metropolitan regions, other metropolitan regions and more developed regions
	Tertiary education	+	All regions, but especially important for urban regions, capital metropolitan regions, other metropolitan regions and more developed regions
	Accessibility	+	All regions, but especially important for capital metropolitan regions
	Level of innovation	+	All regions, but the effect is very small
Fundamental FDI drivers	FDI concentration	+	All regions but especially important for urban and rural regions, non-metropolitan regions, less developed regions
	Population density	+ / -	All regions (positive) but especially important for urban regions (negative) and capital metropolitan regions and transition regions (positive)
	Market size	+	All regions but especially important for urban regions, other metropolitan regions, more developed regions
	Border region	- / +	All regions (negative) but especially important for urban regions (negative), capital metropolitan regions (positive) and more developed regions (negative)
	Dominance of incumbent firms	+	All regions but especially important for urban regions, capital metropolitan regions, non-metropolitan regions and less developed regions

Note: The green plus signs imply that higher values of the regional driver is associated with a higher likelihood of a non-European owned firm being located within the region, while a red minus sign implies the opposite.

Source: ESPON FDI (2018) based on the econometric analysis in the scientific report, *Drivers of extra-European FDI towards Europe*

First, non-European owned firms account for around 4.3 million jobs in the 34 European countries covered in this study, which amounts to five per cent of total employment in these countries. Likewise, non-European owned firms account for 11 per cent of production and nine per cent of value added. The direct impact of extra-European inflows on economic growth is thus significant. However, FDI is highly concentrated in urban, capital metropolitan regions and more developed regions.<sup>7</sup> Not only do the rural, non-metropolitan and less developed regions attract fewer non-European owned firms, but the firms that they host also on average support

<sup>6</sup> More findings on the distribution and composition of extra-European inflows can be found in the scientific report, *Trends and patterns in extra-European FDI inflows towards Europe*.

<sup>7</sup> Less developed regions have a GDP per capita lower than 75% of the EU28 average, transition regions have a GDP per capita between 75% and 80% of the EU28 average, and more developed regions have a GDP per capita above 90% of the EU28 average. More details of these classifications can be found in the scientific report, *Impacts of extra-European FDI towards Europe*.

fewer jobs and generate less revenue than firms in the more advantaged regions. Overall, the contribution of extra-European inflows to convergence across regions in Europe appears to be limited. Policy initiatives directed at the main FDI drivers for the less advantaged regions listed in Figure 9 will be particularly important to accelerate regional convergence in Europe.

*Second*, the composition of FDI differs across regions. M&As accounted for around 70 per cent of the total extra-European FDI inflows into Europe during 2003-2015. M&As mainly take place in regions with developed business structures (developed, urban and capital regions) due to the large pool of mature firms and strong clusters. Greenfield investments and expansions by existing companies account for the remaining 30 per cent. These investments are to a large extent attracted to the more disadvantaged regions (rural, non-metropolitan, transition and less developed regions) due mainly to lower costs and better physical accessibility. As greenfield investments are likely to generate new jobs and revenue, the composition of extra-European FDI supports convergence across European regions. Policy initiatives can strengthen this pattern by targeting some of the drivers that are particularly relevant for greenfield investments.

*Third*, the composition of FDI differs across sectors. The share of FDI in services is higher in more developed, urban and capital regions driven mainly by a higher population density and higher income levels. FDI in manufacturing is located across a larger variety of regions and is driven more by the presence of industry clusters. Policy initiatives to support the development and strengthening of clusters will stimulate FDI inflows in the manufacturing sector where the more disadvantaged regions in many cases have inherent strengths in terms of FDI attraction.

*Fourth*, productivity spillovers from non-European firm accrue both to local firms within the same industry (intra-industry spillovers) and to local firms in other industries (inter-industry spillovers). Extra-European inflows can thus improve the competitiveness of European firms. These productivity spillovers occur via knowledge transfers, increased competition and via vertical (buyer-supplier) linkages with foreign firms. Productivity spillovers from non-European firms are generally larger for local firms in the service sectors than for local firms in the manufacturing sectors. We also find that the productivity spillovers are lower in more disadvantaged regions (rural, non-metropolitan and less developed regions).

There could be several reasons for these findings. Local firms in the more disadvantaged regions may not have the required resources and skills to tap into the knowledge inherent in the non-European owned firms. Similarly, local buyer-supplier linkages may not be sufficiently frequent or strong to generate spillovers across industries. In addition, non-European investors may have invested in Europe in order to acquire new technologies, knowledge or particular assets, and the potential for knowledge spillovers back to local firms may thus be limited. Policy initiatives to improve the absorption capacity of local firms and the integration of non-European firms in local supply chains and networks will increase productivity spillovers and improve the competitiveness of European firms.

## **Initiatives at all levels can help attract more FDI and increase benefits from FDI**

FDI occurs in a rapidly evolving global economy that involves increasingly interconnected and complex value chains. EU policies that make it easy for foreign firms to establish themselves in Europe and do business across borders will stimulate FDI inflows. In particular, EU policy makers could improve the attractiveness of all European regions by implementing initiatives at the **EU level** that:

- **Reinforce the Single Market.** The Single Market offers access to 500 million high value consumers and is thus a huge attraction factor for firms seeking business opportunities abroad. Initiatives to strengthen the Single Market could include a digital single market, an energy union or a capital markets union as described in the Juncker Plan. In terms of improving the digital single market, enhanced transparency and standardisation of consumer and data protection rules could be a way forward, and the same is the case for improved possibilities for cross-border licensing and transferring of copyrights.
- **Ensure political, regulatory and legal predictability.** FDI typically involves large fixed investments (e.g. in buildings, production plants and equipment), and investors are therefore sensitive to any factors that cause a risk to their investment. A stable political, regulatory and legal environment reduces the risk of undertaking FDI in Europe (particularly in light of Brexit). For cross-border investments by non-European owned firms, investor protection secured by EU investment treaties can be particularly important.
- **Integrate Europe globally.** EU transport policies that improve accessibility to and from Europe will give firms placed in Europe better opportunities to optimise their global value chains, which will make it more attractive for non-European owned firms to locate in Europe. Likewise, accessibility to foreign markets ensured by EU trade agreements will make Europe a more attractive location for multinational firms with global operations and client bases. These initiatives will also make it more attractive for European owned firms to expand in Europe and serve foreign markets through exports.
- **Support sustainable growth.** EU policies can support job creation, business competitiveness, economic growth, sustainable development and improve citizen's quality of life. Such initiatives include cohesion policies and initiatives to improve competitiveness, such as research and innovation, education and training, trans-European networks, social policy, economic integration and accompanying policies.<sup>8</sup> Sustainable growth throughout Europe will make Europe as a whole more attractive for firm looking for new business opportunities abroad.

There are several preconditions at the **national level** that are important for all regions to attract and maintain foreign investments. These factors include both fundamentals (demand, quality of institutions, concentration of foreign firms and global cities) that are difficult for policy makers to influence in the short term as well as policy variables (tax rates, wage levels, physical infrastructure, human capital, clusters and cost of location) that can be changed more easily. National policy makers can improve the attractiveness of all regions in the country by implementing initiatives that:

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<sup>8</sup> See [http://ec.europa.eu/budget/explained/budg\\_system/fin\\_fw0713/fin\\_fw0713\\_en.cfm](http://ec.europa.eu/budget/explained/budg_system/fin_fw0713/fin_fw0713_en.cfm) for more information about the EU budget and composition of current expenditures.



- **Ensure efficient collaboration between different layers of public administration.** High-quality institutions (e.g. stable politics, legal certainty, clear timeframes, low corruption and conditions that support personal security) are important for a country's attractiveness. In terms of FDI promotion, it is important that the agility of the regional unit is not compromised by unclear timeframes and rules at the national level as well as duplication of responsibilities at different governance levels. The case studies show that various "one-stop shops" for new investors have proven particularly valuable in locations with less efficient administration and multiple layers of public administration.<sup>9</sup>
- **Use financial incentives selectively.** While financial incentives cannot substitute for an attractive investment climate, the use of financial investment incentives may be a way forward for regions with a low presence of foreign firms to start building up a stock of foreign firms. To have a large impact, it is important that such incentives are used selectively and are adjusted to the regional context, and that the incentives do not discriminate against local firms.
- **Ensure labour market flexibility and integration.** Flexibility in the labour market gives an important incentive for firms to hire new employees, particularly in high-risk business, in times of crisis and for new start-ups. Flexible labour laws that make it possible for companies to scale up and down are highlighted in both the Danish and Irish case studies as drivers of FDI and start-ups. Supplementary initiatives to improve the accessibility of urban centres from related rural territories can increase mobility and help prevent bottlenecks in the labour market. Such initiatives will also reduce regional disparities because benefits are spread to other locations in the functional region.
- **Implement and enforce efficient competition policies.** Enforcement of competition policies and equal treatment of foreign and domestic firms provide a level playing field that reduces the risk for foreign firms to establish a business in the region. This is important in most types of regions, and competition policies could thus benefit from being enforced efficiently by competition authorities at the national level.

The seven case studies offer a rich collection of best practices in attracting FDI and implementing smart specialisation strategies. In summary, the case studies and quantitative analyses point to a set of initiatives at the **regional level** that can stimulate FDI inflows:

- **Strengthen existing clusters or build new clusters around existing strengths.** Initiatives to build strong industry clusters can be a way to ensure sustained regional growth, particularly for less advanced regions where the local market is less attractive and in manufacturing (particularly technology-intensive) sectors. Depending on the characteristics of the specific region and industry, such initiatives could involve public R&D, collaboration between universities and private firms, and various education programs. Strong clusters can also benefit local SMEs and spur entrepreneurship, which will support sustainability and growth in the region. However, to serve as a magnet for foreign investors, a high level of agglomeration maturity is important. A place-based

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<sup>9</sup> Seven case studies have been carried out as part of this study to identify best practices in FDI promotion and provide inspiration on new policy initiatives that can spur FDI inflows towards Europe. The case studies can be found in the scientific report, *Case studies of best practices in FDI promotion*.

approach to building clusters that takes existing strengths into account and is aligned with existing regional development strategies will be particularly efficient.<sup>10</sup>

- **Secure a competitive skills base.** The existence of a strong skills base in the region is an important prerequisite for benefiting from knowledge spillovers and attracting FDI in the more knowledge-intensive sectors. A high level of tertiary education, for example, is thus a particularly strong driver for FDI into urban, capital and other metropolitan regions as well as more developed regions. Likewise, regions with high level of innovation attract more FDI in the more knowledge-intensive sectors.
- **Attract foreign talents.** Regions with a combination of labour abundance and high skill levels attract more FDI, and continued inflows of FDI thus require an abundant pool of qualified labour. Education policies and initiatives to increase labour supply can support this, but many countries and regions also have initiatives in place to attract foreign talent and thereby expand the pool of qualified labour. Classic factors such as affordable housing, international schools, information and activities available in foreign languages, good accessibility for people and strong industry clusters support the attraction of foreign talent, but the case studies also find that economic factors (e.g. tax incentives and wage premiums) play a role in attracting high-level professionals. The case studies also point out that more targeted initiatives are often required, such as investments in a rich cultural environment and accelerated application procedure for highly skilled migrants or 'knowledge migrants'.
- **Invest in accessibility.** Many non-European investors look to the European Single Market as a whole or to large territories within Europe (e.g. North and South) as the end market. Accessibility in terms of transporting goods will be important for regions that brand themselves as production and transportation hubs into other regions and countries. A developed physical infrastructure for transporting goods is found to be particularly important for manufacturing firms, whereas good accessibility for people is more important for firms in the service sectors. Investments in physical infrastructure seem to pay off particularly well in less advantaged regions, e.g. when such investments ensure access to more developed markets, but also in capital metropolitan regions where congestion can create bottlenecks for continued economic growth. In the capital metropolitan regions, accessibility in terms of the mobility of people (e.g. airline connections) is also important. Digital accessibility becomes increasingly important, and initiatives to stimulate and increase benefits from digitisation are highlighted in all seven case studies.
- **Stimulate internationalisation and targeted regional branding.** Regions that already host a large number of foreign companies are more likely to attract even more FDI, particularly FDI from the same origin. This is particularly important for less advanced regions (i.e. rural regions, non-metropolitan regions and less developed regions). Targeting investment promotion activities to partners where bilateral relations are already established could be an efficient way to use these region's FDI promotion resources, and such initiatives could be coordinated at the national level in smaller countries. In addition, international events in key strategic sectors can help strengthen existing clusters. Finally,

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<sup>10</sup> This is also one of the key conclusions in the European Commission (2013), *The role of clusters in smart specialisation strategies*. Both cluster policies and Smart Specialisation Strategies are policy approaches with a place-based dimension, aiming at exploiting advantages of proximity to promote economic growth and competitiveness.

as English is the main business language in extra-EU FDI transactions, a high level and use of English will stimulate FDI inflows.

While the traditional focus of FDI promotion strategies on job creation prevails, more emphasis is now placed on the contribution of foreign firms to the economic development in the region and the competitiveness of local firms. This contribution is facilitated by collaboration between local and foreign firms and productivity spillovers that boost local firms' competitiveness. Optimising such benefits from FDI requires that FDI policies are integrated into regional development policy and form an integral part of the wide range of instruments that are being applied in the region to build competitive advantage (e.g. development of infrastructure, human resources and entrepreneurial networks). Such initiatives to **increase benefits from FDI** could:

- **Integrate foreign firms in the local economy to optimise knowledge spillovers.** Frameworks for cooperation between different regional economic actors can promote innovation and expand regional value chains. Likewise, events that bring people from different sectors and different types of businesses together can facilitate knowledge-sharing and the introduction of new technologies, products and services. This will be particularly beneficial for SMEs.
- **Offer after-care support to established foreign firms.** Given that new jobs and investments in many cases emerge from expansions of foreign firms already located in the region, after-care support is a key ingredient in making a region more attractive and increase benefits from FDI. Ensuring maximum benefit from FDI for the region and building a strong regional "brand" require ongoing contact with firms, even after they are well established in the country. This will stimulate expansions of existing firms and enhance the signalling effect of FDI. Given that the decision to expand and relocate production is not always made by the local management team, after-care can also involve close dialogue with the upper-level management team at the head quarter.

### **Special initiatives are needed to support less advantaged regions**

What comes out clearly in the study is the genuine challenge that is faced by the more disadvantaged regions. Overall, we find that less FDI flows to these regions and that spillovers tend to be smaller. FDI inflows into the transition regions do, however, seem to have had a large direct impact on jobs and economic growth, which have stimulated convergence between the transition and more developed regions. Overall, our finding also suggests that cohesion policies can have a role to play to improve the integration of less advantaged regions in the world economy and that such policies could be used to:

- Strengthen industry clusters around existing strengths, e.g. by using the Smart Specialisation Platform to help the regional and national authorities develop and implement smart specialisation strategies (possibly encompassing a branding and internationalisation strategy).

- Improve the absorption capacity in local firms (e.g. by offering customised training or R&D packages) and build administrative capacity in the public administration (e.g. by supporting the reform of institutions (systems and structures) and assistance to staff of institutions<sup>11</sup>).
- Integrate foreign companies better in regional value chains, e.g. by facilitating inter-firm collaboration and strengthening business networks across regions.
- Improve access to nearby markets, e.g. by investing in infrastructure that improves the region's connectivity to more developed regions.
- Use financial investment incentives selectively, preferably to amplify impacts of a smart specialisation strategy in the region.

### **A place-based approach is required**

What also comes out clearly is that all regions and cities can implement initiatives that will help realise their potential, but also that there is no “one size fits all” strategy for FDI attraction. Rather, it is the combination of the attractive investment climate created by EU, national and regional policies and the application of unique “best practices” strategies fitted to the territorial context that have stimulated FDI inflows in successful regions. With the right policy framework and a place-based approach to FDI promotion, FDI inflows towards Europe can thus support financial stability, promote economic development and enhance the well-being of societies. This study offers new insights into the drivers and impacts of FDI at a regional level that may be useful for regional investment promotion agencies working to refine FDI strategies, to design branding campaigns and to target their communication to different groups of potential investors.

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<sup>11</sup> See, for example, European Commission (2014), *Guidance Document on Indicators of Public Administration Capacity Building*, Programming Period 2014-2020, Monitoring and Evaluation of European Cohesion Policy, European Social Fund.

# 1 Trends and patterns in FDI inflows towards Europe

Multinational firms locate abroad because they expect that the investment will improve the long-term profit and value of the firm. The location of foreign investments will invariably be guided by the firm's motives for engaging in FDI in the first place. Firms may wish to pursue business opportunities in local or nearby markets and will choose the location that offers the best access to the largest market at the lowest cost of trade and transportation (market-seeking FDI). Firms may also wish to improve their productivity by diversifying production to take advantage of different factor endowments and other FDI attraction factors such as investor incentives, economic policies and market structures (efficiency-seeking FDI). Alternatively, firms may locate in foreign markets to secure access to critical resources such as human capital, technology and natural resources (resource-seeking FDI). Finally, FDI may be motivated by strategic considerations where the firm seeks to sustain or advance its long term global competitiveness (strategic FDI).

Regions with similar characteristics will tend to attract the same types of firms, and the composition of FDI across different locations in Europe will thus be different for different types of regions. In this chapter, we address the following questions: 1) What are the trends and patterns in extra-European FDI inflows towards countries and regions in Europe, and 2) What types of regions and cities receive FDI and for which economic activities?

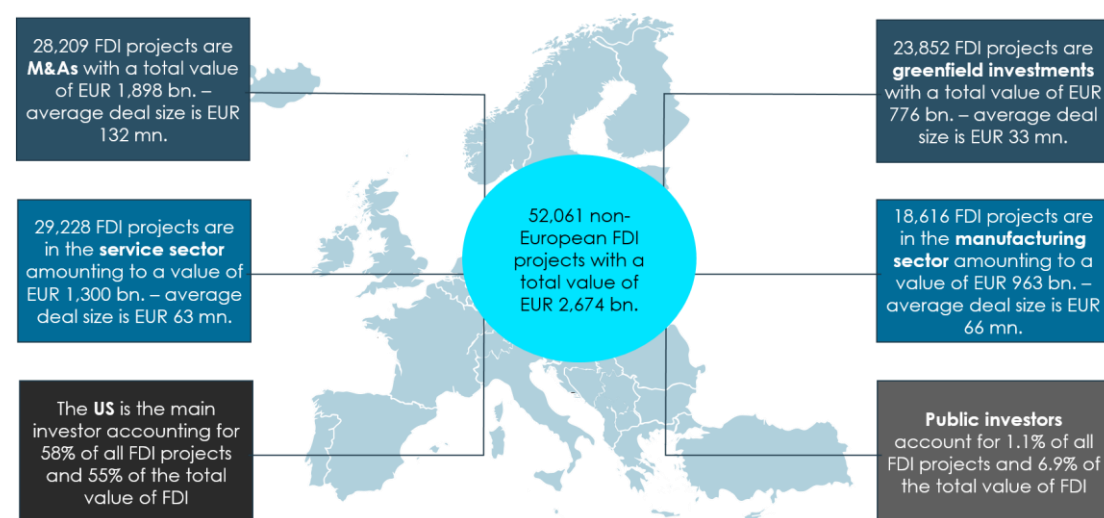
## 1.1 FDI inflows across European countries

During 2003-2015, non-European investors carried out more than 52,000 FDI projects in Europe amounting to a total value of more than EUR 2,600 billion, cf. Figure 2. More than 28,000 projects worth almost EUR 1,900 billion (71 per cent of the total deal value) were M&As with an average deal value of EUR 132 million. Greenfield investments amounted to EUR 776 billion, and the average deal value was EUR 33 million.

The majority of FDI projects were in the service sector (56 per cent), but the average deal value of EUR 63 million was smaller than the average deal value of EUR 66 million for FDI projects in the manufacturing sector. The US is by far the largest non-European investor and accounted for 55 per cent of the total value of extra-European FDI during this period. The significant presence of US firms in Europe increases the exposure of the European economy to political and economic changes in the US, and any emergence of barriers to outward FDI in the US should be closely monitored by European policy makers.

Investments by public investors accounted for 6.9 per cent of the total deal value. While openness to foreign investment remains a key principle for the EU, there is growing concerns about foreign investors, notably state-owned enterprises, taking over European companies with key technologies for strategic reasons.<sup>12</sup> In light of this, the European Commission has put forward a proposal for establishing a framework for screening of FDI into the EU. The objective of the regulation is to “establish a framework for the Member States, and in certain cases the Commission, to screen foreign direct investments in the EU, while allowing Member States to take into account their individual situations and national circumstances.”<sup>13</sup>

**Figure 2 Overview of FDI inflows towards Europe, 2003-2015**



Note: Public investors include, among others, state-owned enterprises from non-European countries. The sector classification is specified in the scientific report, *Trends and patterns in extra-European FDI towards Europe*.

Source: ESPON FDI (2018) based on data from the BvD Zephyr and FT databases. See the scientific report, *Collection of extra-European FDI flows* for further details

The UK, Germany, the Netherlands and France are the main destinations for extra-European FDI, cf. Map 1. The UK alone attracted 30 per cent of the total value of extra-European FDI towards Europe (of which 49 per cent originates from the US). Luxembourg and Cyprus are also large recipients of extra-European FDI inflows, which is mainly due to their competitive tax regime.<sup>14</sup> As the analysis is limited to FDI inflows from non-European countries, FDI inflows into e.g. Germany through a financial centre in Luxembourg will be recorded as FDI flows into

<sup>12</sup> European Commission (2017), *Harnessing Globalisation*. This was also reflected in a common letter from the German, French and Italian governments to the Trade Commissioner Malmström.

<sup>13</sup> European Commission (2017), *Proposal for a Regulation of the European Parliament and of the Council establishing a framework for screening foreign direct investments into the European Union*, {SWD(2017) 297 final}.

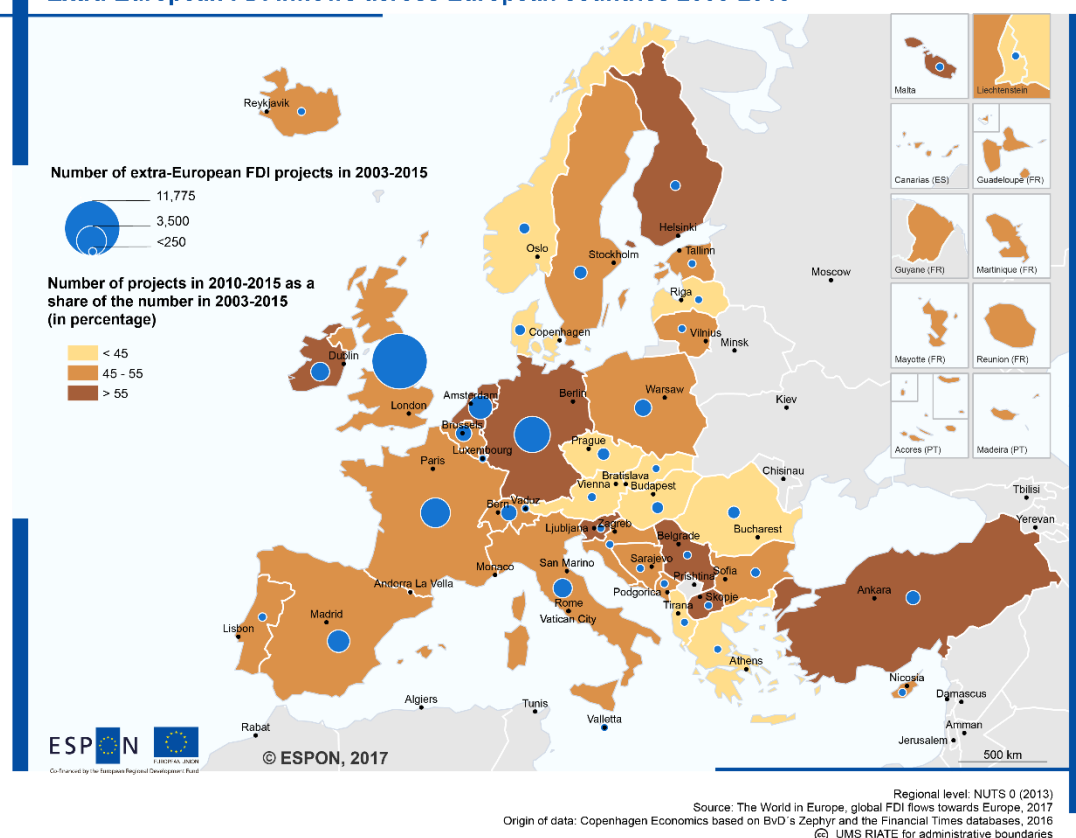
<sup>14</sup> See the scientific report, *Trends and patterns in extra-European FDI towards Europe* for more details on the trends and patterns in FDI inflows into individual countries.

Luxembourg instead of Germany. This may be part of the reason for the large inflows of FDI into especially Luxembourg.<sup>15</sup>

In general, there is a clear tendency for FDI to flow to large countries. The five largest countries in terms of GDP (i.e. Germany, the UK, France, Italy and Spain) thus accounted for almost 60 per cent of total FDI inflows into Europe over the period 2003-2015 (51 per cent of greenfield FDI and 61 per cent of M&As).

## Map 1 FDI inflows across European countries, 2003-2015

### Extra-European FDI inflows across European countries 2003-2015



Note: The FDI values cover both greenfield investment and M&As. Not all M&As listed in the database have a deal value recorded. Of the 28,209 projects recorded, 14,389 have a deal value and are included in this figure. More information about the regional FDI data can be found in the scientific report, *Collection of extra-European FDI flows*.

Source: ESPON FDI (2018) based on the BvD's Zephyr and the FT databases

Taking the economic size of the economies into account, the Netherlands and Ireland are the most successful countries in terms of attracting FDI. During 2003-2015, the Netherlands accounted for 4.4 per cent of the combined European GDP but 9.9 per cent of the total value of FDI inflows towards Europe, whereas Ireland accounted for 1.3 per cent of the combined GDP and 2.6 per cent of FDI inflows into Europe. Both countries have a very attractive

<sup>15</sup> See the scientific report *Collection of extra-European FDI flows* for further details.

investment climate measured in terms of cost and quality drivers of FDI, such as clusters and agglomeration, infrastructure and accessibility, as well as costs, productivity and resource availability.<sup>16</sup>

The case studies carried out as a part of this project show that the Greater Hague Region is one of the regions in the Netherlands that has been successful in turning an attractive investment climate into large FDI inflows. The strategy to attract FDI into the region builds on close collaboration between the national and regional level under the umbrella of the Investment Development Programme implemented by the Netherlands Foreign Investment Agency. The regional investment promotion agencies are organised as regional development agencies, which enables them to better integrate foreign companies into the local business community and support indirect job creation through the use of local suppliers. Concrete initiatives to attract FDI are described in the case study report, such as the initiative to use feedback from existing foreign companies to advance the business climate and offer attractive options for firms that need to hire foreign labour (the Dutch Highly Skilled Migrant Programme).

**CASE**  
**The Netherlands: The Greater Hague Region**  
A metropolitan, non-capital and urban region with a high level of development. The region has an international focus and receives mostly M&As in the ICT sector.

- Foreign companies have a large direct economic footprint – responsible for 15% of GDP and 20% of jobs in the Netherlands
- Compared to a domestic enterprise, foreign companies provide
  - 30 times more jobs – with higher job stability and wages
  - More indirect jobs through suppliers
  - More intensive training of employees with potential spillovers to local firms
- The strategy to attract FDI in R&D and ICT includes close collaboration between the national and regional level and that regional investment promotion agencies are organised as regional development agencies aiding the integration of foreign companies into the Dutch business community
- The drivers for FDI are multiple, including
  - Well-educated, multilingual labour
  - Advanced tax ruling system
- Constraint: Insufficient availability of technical skills i.e. higher education specialists with specific ICT-knowledge



Source: ESPON FDI (2018). More details can be found in the scientific report, *Case studies of best practices in FDI promotion*

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<sup>16</sup> The FDI Attractiveness Scoreboard developed by Copenhagen Economics on behalf of DG Grow ranks 44 countries on 18 cost and quality indicators. Ireland comes out as the fourth most attractive country, and the Netherlands comes out as the fifth most attractive country. See Copenhagen Economics (2016) for more details.



Brexit is likely have an impact on FDI flows towards both the UK and other EU member states, but the extent to which Brexit will influence the location of future FDI inflows towards Europe and cause reallocations of existing investments between the UK and the EU remains to be seen. Some of the mechanisms through which Brexit may impact on FDI towards Europe are summarised below.

*First*, higher uncertainty and lower growth may make the UK a less attractive location relative to the EU in the short term. Likewise, the lower size of the Single Market (the UK accounts for 16 per cent of the combined EU GDP<sup>17</sup>) is likely to make it more difficult for EU member states to compete for global FDI flows relative to other parts of the world, including the US, Singapore and the emerging markets in the BRIC countries. In the long term, the UK's attractiveness will depend on the new policy regime that will be put in place after Brexit on the one hand, and the ability of the remaining EU member states to further harmonise and remove barriers to trade and investments in the Single Market on the other.

*Second*, trade between the EU and the UK is likely to become less frictionless, which will increase cross-border trade costs. Increased costs of intermediate goods trade may disrupt cross-border value chains, and increased costs of final goods trade will tend to make it more profitable to locate production closer to consumption. Firms based in the UK that are either highly integrated in European value chains or dependent on selling to the EU market will likely find the EU relatively more attractive after Brexit. The opposite is the case for firms based in the EU that are dependent on trade with the UK. Higher trade costs will also tend to make the EU more attractive relative to the UK for firms from third countries that seek access to consumers in the Single Market.

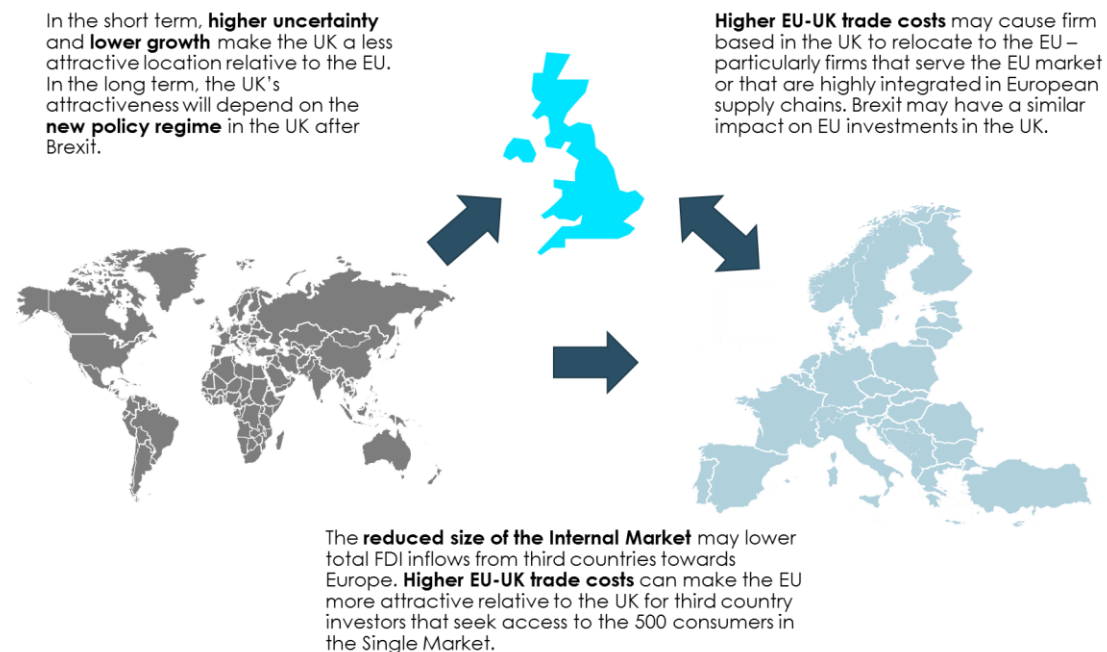
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<sup>17</sup> Based on data from Eurostat, <http://ec.europa.eu/eurostat/web/products-eurostat-news/-/DDN-20170410-1>.

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### Figure 3 Possible impacts of Brexit on FDI towards the EU

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Source: ESPON FDI (2018)

## 1.2 FDI inflows across European regions

The findings in this report are based on a unique and very detailed database on FDI for NUTS3 regions in Europe, which we have built as a part of this project. In building this database, we have combined several databases and carried out thorough cleaning and quality assurance procedures.<sup>18</sup> Of the 52,061 FDI projects by non-European investors recorded during 2003-2015, 44,373 projects can be mapped at the NUTS3 level. For the rest of the projects, we only have information about the country.

In this study, we analyse the distribution of FDI across European regions in order to map their competitiveness and attractiveness to foreign investors. We use three different measures of FDI inflows:

1. The share of non-European firms among the total number of firms in a region, measuring a region's ability to attract non-European firms in the first place as well as making them stay and survive in the longer term.
2. The value of FDI inflows into the region as a share of total FDI inflows towards Europe, measuring a region's competitiveness and ability to attract large FDI projects with a significant capital injection into the local economy.

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<sup>18</sup> The methodology used to collect the data has been described in more details in the scientific report, *Collection of extra-European FDI flows*. This scientific report also contains an assessment of the coverage and quality of the regional FDI data used in this report.

3. The number of FDI projects in the region as a share of the total number of FDI projects in Europe, measuring a region's competitiveness and ability to attract a large number of FDI.

Large regions will, all else equal attract more FDI, and we therefore compare the regional distribution of FDI towards Europe with the regional distribution of GDP. Regions that attract more than their economic size would have predicted will therefore have a stronger FDI performance. We group the regions in order to detect patterns in the location of non-European investors across Europe. *First*, we use the Eurostat typology to identify rural, intermediate and urban regions. *Second*, we use the Eurostat typology to identify capital metropolitan and other metropolitan regions, and we classify the remaining regions as non-metropolitan regions. *Third*, we classify the regions according to their level of development as follows: Less developed regions have a GDP per capita lower than 75 per cent of the EU28 average, transition regions have a GDP per capita between 75 per cent and 90 per cent of the EU28 average, and more developed regions have a GDP per capita above 90 per cent of the EU28 average.<sup>19</sup>

Irrespective of how FDI is measured, FDI is highly concentrated across European territories with non-European owned firms being located mainly in urban regions (69 per cent), capital metropolitan regions (54 per cent) and more developed regions (79 per cent), cf. Table 1. These regions account for an even larger share when measured in terms of FDI value or number of FDI projects.

**Table 1 FDI inflows across different groups of regions**

Groups of regions	Share of European GDP 2003-2015	Measures of FDI inflow		
		(1) Share of non-European firms located in Europe	(2) Share of FDI inflows from non-European countries 2003-2015 by value	(3) Share of FDI inflows from non-European countries 2003-2015 by number of projects
Urban regions	54.6%	70%	71.8%	72.4%
Intermediate regions	32.7%	23%	22.8%	21.2%
Rural regions	12.6%	6%	5.3%	6.4%
Capital city metropolitan regions	22.6%	55%	42.0%	42.4%
Other metropolitan regions	44.2%	26%	34.2%	36.2%
Non-metropolitan regions	33.2%	19%	23.8%	21.4%
More developed regions	73.1%	78%	83.6%	81.8%
Transition regions	14.5%	6%	8.8%	10.0%
Less developed regions	12.4%	16%	7.6%	8.2%

Note: The figures do not include regions in Albania, Bosnia & Herzegovina, Serbia and Turkey. The figures on share of European GDP do not include Iceland, Liechtenstein and Switzerland.

Source: ESPON FDI (2018) based on data from the BvD Zephyr and FT databases in combination with Amadeus data

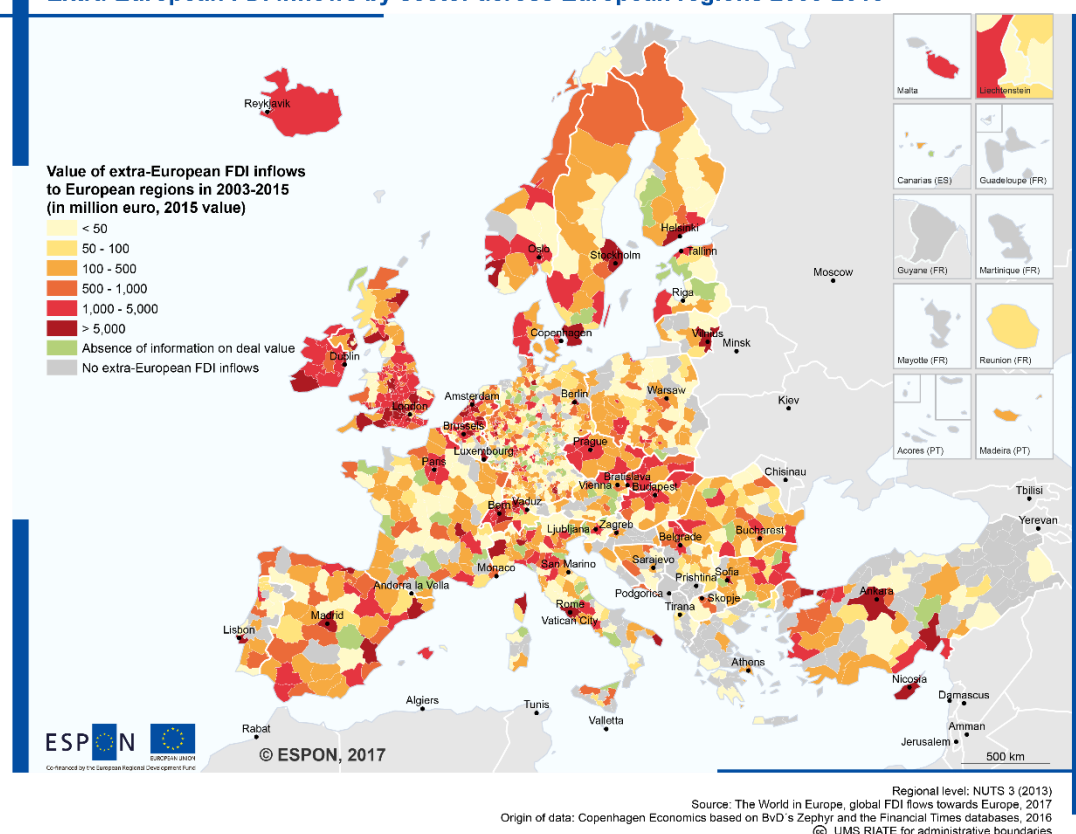
<sup>19</sup> More details of these classifications can be found in the scientific report, *Impacts of extra-European FDI towards Europe*.

Relative to their economic size (measured by regional GDP), urban, capital metropolitan and more developed regions also account for a disproportionately high share of FDI inflows towards Europe. Urban regions, for example, account for around 55 per cent of the total EU GDP but host 69 per cent of the total number of non-European owned firms in Europe and attract around 72 per cent of the total FDI inflows into Europe (measured both in terms of number of projects and value of FDI). These advantaged regions thus appear to have some characteristics besides their economic size that make them attractive locations for FDI. The opposite is the case for the remaining regions. Rural regions, for example, account for almost 13 per cent of European GDP, but host only 6 per cent of the non-European owned firms in Europe and attract 5-6 per cent of total FDI inflows towards Europe.

The NUTS3 regions with the largest FDI inflows during 2003-2015 are Greater Amsterdam (EUR 104 billion), Camden & City of London (EUR 74 billion), Madrid (EUR 54 billion), Hauts-de-Seine (EUR 52 billion), Luxembourg (EUR 52 billion) and Paris (EUR 52 billion). These are all urban, metropolitan regions with a high level of development. Overall, FDI inflows tend to be concentrated around larger cities, with capital metropolitan regions receiving the largest inflows of FDI across most of Europe, cf. Map 2.

## Map 2 FDI inflows across European regions, 2003-2015

### Extra-European FDI inflows by sector across European regions 2003-2015



Note: The FDI values cover both greenfield investment and M&As. Not all M&As listed in the database have a deal value recorded. Of the 28,209 projects recorded, 14,389 have a deal value and are included in this figure. More information about the regional FDI data can be found in the scientific report, *Collection of extra-European FDI flows*.

Source: ESPON FDI (2018) based on BvD's Zephyr and the FT databases

Ireland is one of the countries where FDI seems to be more equally disbursed across regions. The case study on Dublin and the Mid-East Region in Ireland shows that this is due to a strategic FDI policy statement<sup>20</sup> and the aligned targeted FDI strategy aimed at maximising the potential of regions outside the capital and ensuring that the benefits of different locations are communicated effectively to investors. The aligned strategy is driven by IDA, the national investment promotion agency that operates under the auspices of Department of Business, Enterprise and Innovation (DBEI). As part of the initiative, DBEI engages private and public actors in developing action plans and growth targets for each of the regions, and IDA Ireland plays a key role in their development and implementation.<sup>21</sup> IDA, together with its parent department, Enterprise Ireland (the agency with responsibility for the development of internationally focused indigenous firms) and Science Foundation Ireland (responsible for

<sup>20</sup> Policy Statement on Foreign Direct Investment in Ireland, July 2014, Department of Business, Enterprise and Innovation (DBEI).

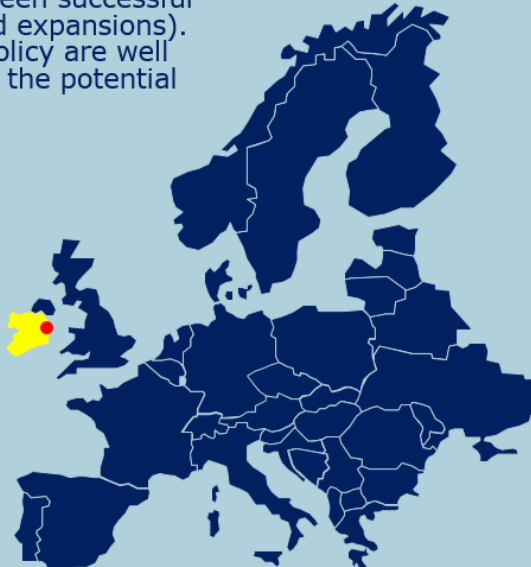
<sup>21</sup> See also <https://www.djei.ie/en/What-We-Do/Business-Sectoral-Initiatives/Regional-Action-Plans-for-Jobs/>.

investment in scientific and engineering research) also aim at developing sectoral ecosystems by aligning business sectors with regional strengths.

**CASE**  
**Ireland: Dublin and the Mid-East Region**

A metropolitan, capital and urban region with a high level of development. The region has been successful in attracting FDI (mostly greenfield and expansions). FDI policy and regional development policy are well integrated, with a focus on maximising the potential of regions throughout the country.

- Foreign firms supported by IDA have a large economic footprint on the regional economies, being responsible for
  - Around 200,000 jobs in Ireland with 96,300 in the Dublin and the Mid-East Region
  - Creating business opportunities for local suppliers to the multinationals
- Main sectors include software, ICT, business, life sciences, biopharma, medical devices and financial service sectors
- IDA works to maximise the potential of regions outside the capital – supporting public and private actors in developing regional action plans and growth targets
- The main drivers for FDI in Ireland include
  - Young and highly skilled labour force
  - Favourable business environment
  - Cultural alignment with the US
- Constraint: New infrastructure is required to support continued growth



Source: More details can be found in the scientific report, *Case studies of best practices in FDI promotion*

### 1.3 The location of M&As and greenfield investments across different types of regions

Greenfield investments take place when a new foreign firm establishes itself in the region and sets up new production facilities, e.g. to access new markets or reduce its costs of production. This type of FDI stimulates economic activity in the region during the construction phase and expands the capital stock in the region.

M&As take place when a foreign firm acquires more than 10 per cent of the voting stock in an existing domestic firm, e.g. to secure access to critical resources (e.g. human capital, technology and natural resources) or for strategic reasons. M&As may help sustain existing economic activity in the region, but this type of FDI does not have an immediate impact on the capital stock in the region. Over time, the change of ownership may improve the competitiveness of the firm and stimulate growth.

M&As accounted for more than 70 per cent of the total value of FDI inflows towards Europe during 2003-2015, and the pattern of M&As across regions thus to a large extent resembles the pattern of total FDI inflows. M&As mainly take place in more developed, urban and capital

regions where there is a larger pool of local firms that could potentially be acquired. During 2003-2015, the M&As in Europe were distributed as follows:<sup>22</sup>

- 89 per cent went to more developed regions, 7 per cent to transition regions and 4 per cent to developing regions.
- 75 per cent to urban, 22 per cent to intermediate and 3 per cent to rural regions.
- 46 per cent per cent to capital city metropolitan regions, 32 per cent for other metropolitan regions and 22 per cent to non-metropolitan regions.

Greenfield investments and expansions by existing firms account for the remaining 30 per cent. As greenfield investments expand the capital stock, it is more likely that greenfield investments create new jobs in the short to medium term and thus to stimulate economic growth. The share of greenfield investments is generally higher in a large number of provincial regions in Eastern Europe as well as Spain and Ireland, cf. Map 3. M&As occur via the transfer of ownership of existing facilities. In contrast to greenfield investments, which include the establishment of new production facilities, M&As do therefore not have an immediate impact on the capital stock in the region.

Greenfield investments in Eastern Europe are, to a large extent, driven by these countries' abundance of qualified low costs labour and their access to the Single Market.<sup>23</sup> Some explanations for the high number of greenfield investments in Spain are its industrial base, surrounding supply chains, quality of labour, the innovative and entrepreneurial culture and the low office space costs as described in the case study on the Catalonia Region, whereas the competitive tax regime in addition to the effective relationship management and after care services described in the case study on the Dublin and the Mid-East Region contribute to attracting a large number of greenfield investments to Ireland.

During 2003-2015, greenfield investments by non-European owned firms in Europe were distributed as follows:<sup>24</sup>

- 66 per cent went to more developed regions, 14 per cent to transition regions and 20 per cent to developing regions.
- 61 per cent to urban, 27 per cent to intermediate and 3 per cent to rural regions.
- 29 per cent per cent to capital city metropolitan regions, 40 per cent for other metropolitan regions and 31 per cent to non-metropolitan regions.

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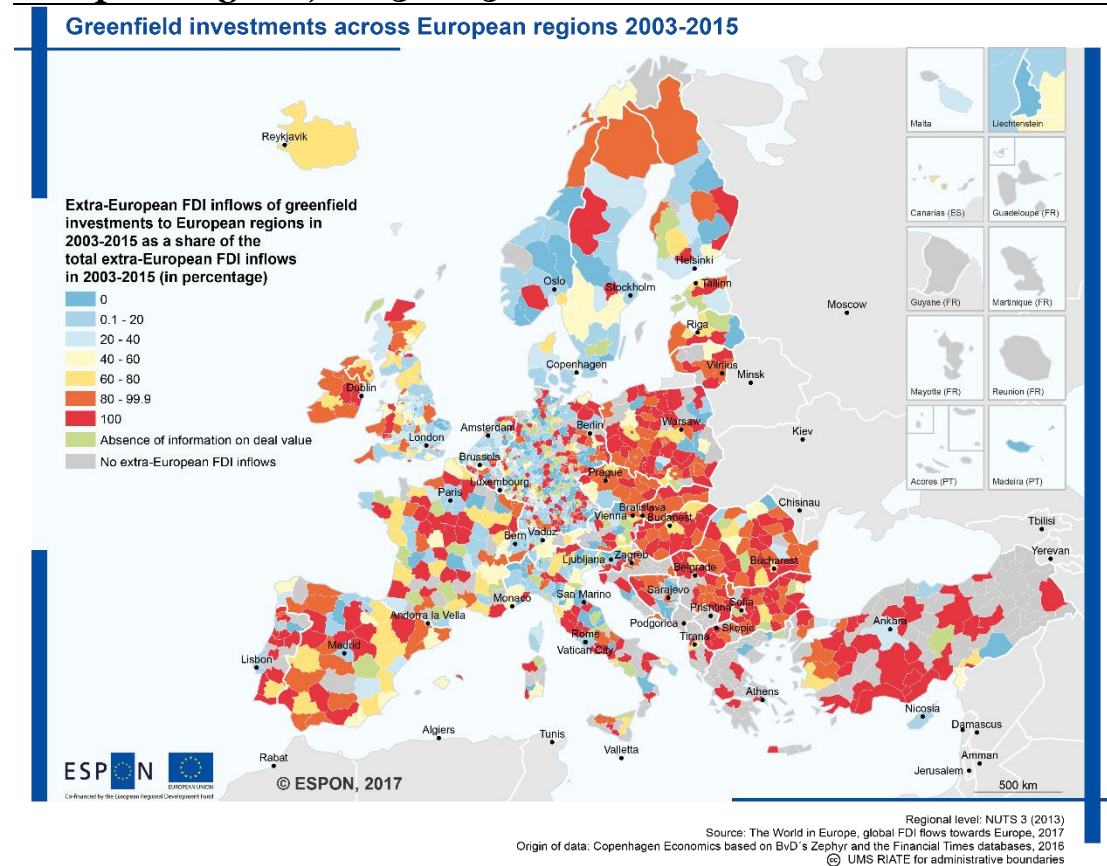
<sup>22</sup> See the scientific report, *Trends and patterns in extra-European FDI towards Europe*.

<sup>23</sup> See Copenhagen Economics (2016).

<sup>24</sup> See the scientific report, *Trends and patterns in extra-European FDI towards Europe*.

Compared to M&As, greenfield investments seem to be located in the less advantaged regions to a greater extent. As greenfield investments expands the capital stock and supports new jobs to a larger extent than M&As, the fact that a larger share of greenfield than M&A investments flow to less advantaged regions suggests that the composition of FDI helps stimulate convergence across European regions.

### Map 3 Share of greenfield investments in total FDI across European regions, 2003-2015



Note: For a number of regions, no greenfield investments have been registered.

Source: ESPON FDI (2018) based on data from the BvD Zephyr and FT databases

#### 1.4 The sectoral composition of FDI across different types of regions

The majority of the non-European owned firms in Europe are found in the service sector. Of the more than 102,500 non-European owned firms included in the analysis, 81 per cent are in the service sector, while 9 per cent are in manufacturing.<sup>25</sup> The remaining 10 per cent are either in other sectors or have no information on sector affiliation. The large number of FDI projects in the service sector, for example, reflects a large number of investments in the retail and wholesale sector where new sales offices and individual stores are recorded as a FDI project.

<sup>25</sup> Based on the Amadeus database.



The motive for locating abroad differs across sectors. Market-seeking FDI in the service sectors, for example, tends to be oriented more towards serving the local market (because services are generally less tradable across borders), whereas market-seeking FDI in manufacturing sectors tends to be more oriented towards nearby markets with easy access from the region. If the motive for undertaking these investments differs, so will the location pattern of FDI across different types of regions.

The share of FDI in services is higher in more developed, urban and capital regions. During 2003-2015, FDI inflows towards the European service sectors were distributed as follows:

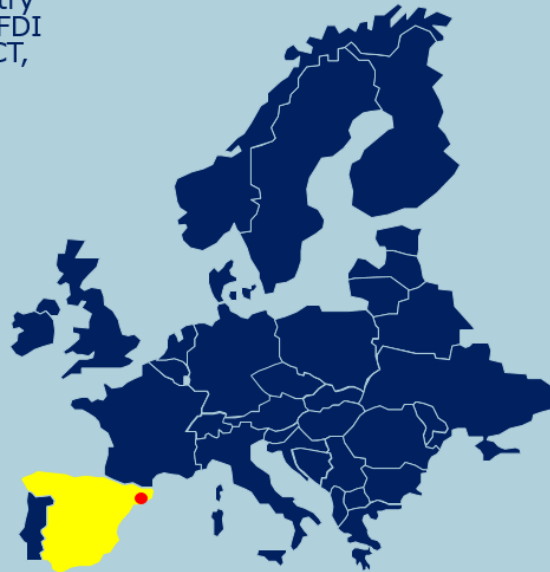
- 90 per cent went to more developed regions, 7 per cent to transition regions and 4 per cent to developing regions.
- 79 per cent to urban, 18 per cent to intermediate and 3 per cent to rural regions.
- 54 per cent to capital city metropolitan regions, 28 per cent for other metropolitan regions and 17 per cent to non-metropolitan regions.

The Catalonia Region in Spain is an example of a developed region that does well in terms of attracting FDI in the service sectors. Catalonia has a strong and highly diversified industrial base that supports a wide presence of complementary suppliers and services. Catalonia's firm commitment towards the digitisation of advanced manufacturing (Industry 4.0) is preparing them for the new demands and offering new opportunities for greater investment in complementary services. In addition, the Smart Specialisation Strategy has aligned to interesting developments taking place in the region in software, ICT (e.g. as a hub for 3D printing) and bio-technologies, which are attracting FDI and helping revitalise the regional economy. The traditional sectors are not considered in the strategy. The inflow of FDI into the service sector has been triggered to a large extent by the fervent innovation ecosystem combined with the wide presence of start-ups and technological infrastructure.

## CASE Spain: Catalonia Region

A developed region that spans all levels of metropolitanism and hosts 30 industry clusters. It mostly receives greenfield FDI with the key sectors being software, ICT, manufacturing and services.

- FDI has a major impact on the Catalan economy and society, generating
  - 18% of the regional employment
  - 41% of the regional exports
  - Human capital development
- The main sectors are software, IT, manufacturing and business and financial services
- The strategy to attract FDI has recently focused on filling industry gaps, but emphasis remains on target sectors (close alignment with the Smart Specialisation Strategy) with strong emphasis on after-care
- The drivers for FDI are multiple and include
  - Access to a large market
  - A highly diversified economy
  - Well-functioning infrastructure
  - 30 industry clusters
- Constraint: Bureaucracy, unclear procedures and legal uncertainty related to foreign investments



Source: ESPON FDI (2018). More details can be found in the scientific report, *Case studies of best practices in FDI promotion*

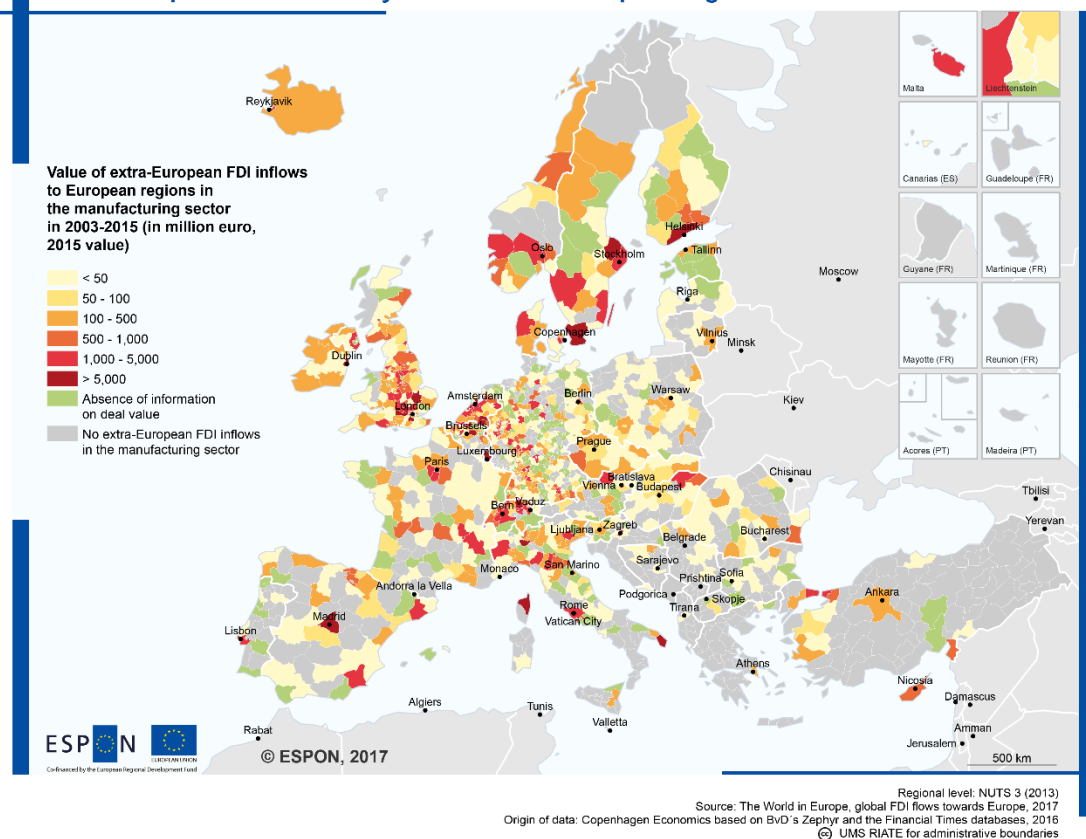
FDI in manufacturing is located across a more wide variety of regions:

- 78 per cent went to more developed regions, 11 per cent to transition regions and 11 per cent to developing regions.
- 63 per cent to urban, 28 per cent to intermediate and 9 per cent to rural regions.
- 34 per cent per cent to capital city metropolitan regions, 36 per cent for other metropolitan regions and 30 per cent to non-metropolitan regions.

The regional distribution of extra-European FDI inflows towards the European manufacturing sectors can be seen in Map 4. The top 10 regions have FDI inflows in the manufacturing sector ranging between 13 and EUR 34 billion and are all located in capital cities or metropolitan regions. The top performer is Greater Amsterdam.

## Map 4 Value of FDI inflows in manufacturing across European regions, 2003-2015

### Extra-European FDI inflows by sector across European regions 2003-2015



Note: The sector classification is specified in the scientific report, *Trends and patterns in extra-European FDI towards Europe*.

Source: ESPON FDI (2018) based on data from the BvD Zephyr and FT databases

### 1.5 Concluding remarks

During 2003-2015, non-European investors carried out more than 52,000 FDI projects in Europe amounting to a total value of more than EUR 2,600 billion.

M&As accounted for more than 70 per cent of the total FDI inflows towards Europe during 2003-2015. The composition of FDI inflows towards Europe during 2003-2015 shows that M&As mainly take place in more developed, urban and capital regions where the pool of local firms available for take-over is larger. Policies that improve the overall business environment in the region and make it easier for new firms to establish and grow will increase the pool of attractive firms and make the region more attractive for M&A investors. Policies that help local firms start-up and scale-up also stimulate FDI inflows.

Greenfield investments and expansions by existing companies account for the remaining 30 per cent. These investments are attracted to more peripherally located regions, and rural regions, non-metropolitan regions as well as transition and less developed regions perform particularly well in terms of attracting greenfield investment. As greenfield investments are likely to generate new jobs and revenue, the fact that a larger share of greenfield than M&A

investments flow to less advantaged regions helps support convergence across regions. Cohesion policies could strengthen this pattern by targeting some of the drivers that are particularly relevant for greenfield investments.

The share of FDI in services in total FDI inflows is higher in more developed, urban and capital regions, whereas FDI in manufacturing is located across a larger variety of territories. Again, this finding suggests that the drivers of FDI in manufacturing seem to be particularly relevant for developing policies that support convergence across European regions. The drivers that are particularly important for FDI in the manufacturing sector are summarised in Chapter 3.

## 2 The relevance of FDI inflows for regional growth, competitiveness and convergence

FDI inflows can create new jobs and stimulate GDP growth. Non-European owned firms account for around 7.7 million jobs in Europe, which amounts to five per cent of the total employment.<sup>26</sup> Likewise, non-European owned firms account for 11 per cent of production and nine per cent of value added. The *direct* impact of FDI inflows is thus significant. However, FDI inflows and benefits are unevenly distributed across different types of regions, and there is therefore no guarantee that FDI inflows will stimulate convergence across European regions.

Foreign firms also hold technical, operational and managerial knowledge that local firms can tap into and improve their productivity. Besides the direct impact, FDI may therefore also be associated with positive *spillover effects*.

Positive direct impacts and spillovers help explain why European countries, like other nations around the world, make significant efforts to attract foreign firms. However, a net positive impact of FDI inflows on the regional economy cannot be taken for granted. Foreign firms may crowd out local firms and force inefficient local firms out of the market, which could result in a loss of jobs in the region. The knowledge spillovers may also be limited, e.g. if the local firms have limited interaction with the foreign firm or have low absorption capacity. The impact of FDI in terms of positive productivity spillovers and increased competitiveness of local firms will depend, among others, on characteristics of the firms and the regional economy.

In this chapter, we address the question: What relevance do inward FDI flows have for regional growth and competitiveness as well as for reducing economic disparities in Europe?

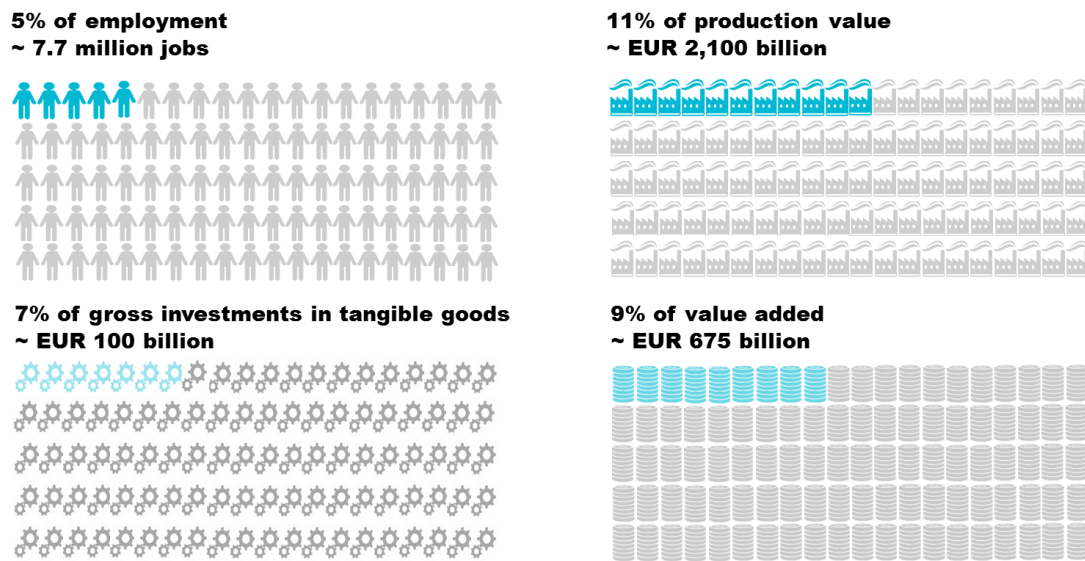
### 2.1 Direct impacts of FDI inflows across European regions

Non-European owned firms contribute disproportionately to the European economy. While non-European owned firms account for, approximately, on average, only one per cent of the total number of firms, they account for an average of five per cent of employment, 11 per cent of production and nine per cent of value added, cf. Figure 4. Non-European owned firms also account for a disproportionately high share (seven per cent) of investments in tangible goods, which cover investments in capital goods, including land.

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<sup>26</sup> Based on 29 European countries for which data are available.

## Figure 4 Indicators of the direct impact of non-European owned firms in Europe



Note: The average share of each of the four outcomes measures those accounted for by non-European owned firms across individual European countries. This is measured as the simple average across all 29 European countries for which data is available. The country specific results can be found in the scientific report, *Impacts of extra-European FDI towards Europe*.

Source: ESPON FDI (2018) based on Eurostat's Foreign Affiliates and Structural Business Statistics

Urban, capital city metropolitan and more developed regions host a larger number of non-European owned firms, and non-European owned firms also account for a larger share of the total number of firms in these regions. Urban regions on average host 213 non-European owned firms, which amount to 1.1 per cent of all the firms in these regions, cf. Table 2. For comparison, rural regions on average host 17 non-European owned firms, which amount to 0.3 per cent of the total number of firms in these regions.

Not only do the less advantaged regions attract fewer non-European owned firms, but the firms that they host also on average support fewer jobs and generate less revenue than non-European owned firms in the more advantaged regions. Non-European owned firms in urban regions have 47 employees on average and an operating revenue of EUR 21 million. For comparison, non-European owned firms in the rural regions have 27 employees on average and generate an operating revenue of EUR 6.3 million.

The same pattern appears when we compare capital city metropolitan regions with non-metropolitan regions and more developed regions with less developed regions. More developed regions on average host more non-European firms (137 firms compared to 41 for the less developed regions), and the non-European owned firms also support more jobs than in less developed regions (on average 45 jobs in the more developed regions and 25 in the less developed regions).

Transition regions host an even lower number of non-European owned firms (on average 27 non-European firms in the transition regions), but these firms support a larger number of jobs

(on average 81 jobs) than in more developed and less developed regions and generate a lower level of revenue than in the more developed regions but higher than in the less developed regions (on average EUR 16.2 million). Extra-European FDI inflows thus appear to have supported convergence for the transition regions but not for the less developed regions.

**Table 2 Direct impact of FDI across different types of regions**

	Average number of non-European owned firms	Average share of non-European firms (per cent)	Average number of employees in non-European owned firms	Average operating revenue in non-European owned firms (EUR, million)
Urban regions	213	1.1	47	21.0
Intermediate regions	48	0.6	37	15.1
Rural regions	17	0.3	27	6.3
Capital metropolitan regions	575	1.7	47	18.4
Other metropolitan regions	72	0.6	39	22.2
Non-metropolitan regions	26	0.4	44	16.0
More developed regions	137	1.1	45	22.7
Transition regions	27	0.4	81	16.2
Less developed regions	41	0.5	25	4.0

Note: The table shows the average characteristics of non-European owned firms in the different types of territories. Operating revenue measures a firm's revenue (sales) generated from a company's day-to-day business activities, which means revenue posted from selling the company's products and services. Details of the classifications can be found in the scientific report, *Impacts of extra-European FDI towards Europe*.

Source: ESPON FDI (2018) based on data from the Amadeus database

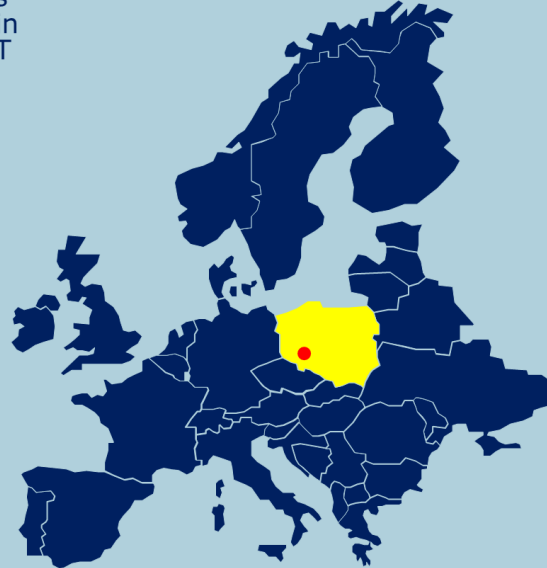
Wroclaw and the Lower Silesia Region in Poland is a case where FDI has supported growth and reduced unemployment and regional disadvantage. This success can largely be attributed to strong political support for FDI in Wroclaw, the first city in Poland to have an investment promotion agency. Alongside the direct effect of jobs creation, foreign companies have had an indirect effect on the economy of the region by reducing the size of the informal labour market. Once workers understood the benefits of being part of the formal labour market, it became difficult for local companies to compete for talent without offering similar conditions. Thus, job growth from a taxation perspective has actually been even greater than the reduction in unemployment, as employment shifted from the informal market to the formal market where workers pay taxes. Perhaps the most important element of the FDI approach in this case is the focus on knowledge economy jobs. While the city will present an offer to any company interested in investing, it does not compete aggressively for projects that require a high share of manual labour or investors who are simply looking for a low-cost way to do business in Europe. This focus on high value-added activities ensures that FDI makes a positive contribution to regional development. It also protects the long-term economic future of the region by ensuring a critical mass of companies that are less likely to leave the region when the inevitable development of the Polish economy increases the cost of doing business.

## CASE

### Poland: Wrocław and the Lower Silesia Region

A region with areas varying in levels of development and urbanisation that has experienced a surge in greenfield FDI in mainly high-tech sectors, software, ICT and electronics.

- FDI has created large benefits for Wrocław
  - Unemployment reduced from 12% in 2002 to 4.2% in 2015 and from 14% to 11% in the surrounding area
  - Labour has moved from the informal to the formal labour market – spillover effects on local companies
- The main sectors are software and IT services and electronics
- The FDI strategy is focused on jobs in the knowledge-economy requiring technical skills, less on projects with high manual labour share
- The main drivers for FDI are
  - A highly skilled labour force in an academic centre
  - Central placement in Europe
- Constraint: An ageing population and increasing cost of living reduces mobility



Source: ESPON FDI (2018). More details can be found in the scientific report, *Case studies of best practices in FDI promotion*

## 2.2 Potential spillovers from FDI to local firms

Productivity spillovers can accrue to local firms within the same industry (intra-industry spillovers) or to local firms in other industries (inter-industry spillovers). Productivity spillovers to local firms within the same industry can occur via knowledge transfers and increased competition, while productivity spillovers to local firms in other industries can also occur via vertical (buyer-supplier) linkages with foreign owned firms, cf. Figure 5.

Knowledge transfers from foreign owned firms are expected to have a positive impact on the productivity of local firms (both within the same industry and in other industries) and may occur through multiple channels. *First*, local firms may gain new knowledge by hiring former employees of foreign firms (labour mobility) who bring with them technical or managerial know-how.<sup>27</sup> *Second*, local firms may learn from imitating foreign firms' managerial practices or production methods by, for example, adopting a similar technology (imitation/demonstration). *Finally*, the knowledge foreign firms hold about export markets (e.g. knowledge regarding consumer tastes, international standards, distributional channels, etc.) may also spill over to local firms and help them get a foothold on export markets. As local firms start exporting they






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<sup>27</sup> Empirical evidence supports the importance of labour productivity as a channel of productivity spillovers from multinational enterprises to non-multinational enterprises, as discussed in the scientific report, *Impacts of extra-European FDI towards Europe*.



will be better able to exploit economies of scale and will be exposed to increased competition, which may result in productivity enhancements.

**Figure 5 Channels of productivity spillovers from FDI to local firms**

		Spillovers to firms within the same sector and region (intra-industry)	Spillovers to all firms in the region (inter-industry)
<b>Knowledge transfer</b>	 <b>Labour mobility</b> Local firms can hire former employees of foreign firms	+ • Labour movements	+ • Labour movements
	 <b>Imitation/demonstration</b> Local firms can learn/copy from foreign firms	+ • Imitation of foreign firms' products and production processes	+ • Imitation of foreign firms' production processes
	 <b>Exporting</b> Local firms can get a foothold on export markets	+ • Learning by exporting + • Economies of scale	+ • Learning by exporting + • Economies of scale
	 <b>Competition</b> Local firms are forced to become more productive or leave the market	+ • Reduction in inefficiency + • Faster adoption of new technology - • Increased cost of specialised labour - • Dis-economies of scale	- • Increased cost of specialised labour
	 <b>Vertical linkages</b> Linkages between foreign firms and local buyers and suppliers		+ • Direct relations between foreign firms and local buyers and suppliers + • Economies of scale - • Dis-economies of scale

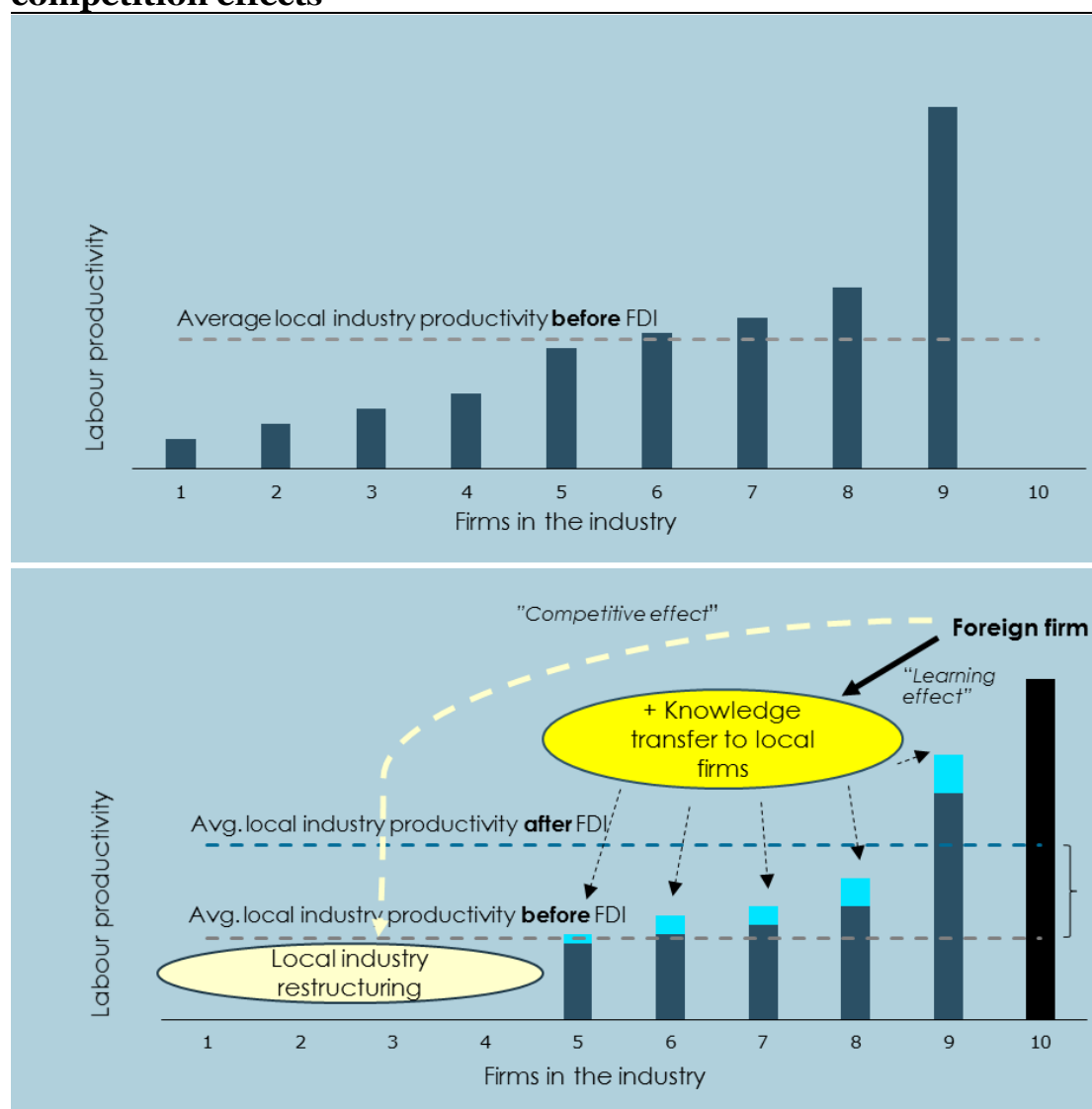
Source: ESPON FDI (2018) based on the literature survey referenced in the scientific report, *Impacts of extra-European FDI towards Europe*

Increased *competition*, arising from the entry of a foreign firm, can also result in productivity enhancements among local firms in the same industry. This can occur if the competitive pressure is large enough to give local firms an incentive to use their resources more efficiently or to adopt new technologies in order to survive in the market. The least efficient local firms that are not able to survive when competition increases will be forced to leave the market. This restructuring combined with productivity enhancements among the surviving local firms through knowledge transfers and increased competition, cause the average local industry productivity to increase as illustrated in Figure 6 (below).

Via competition effects, however, foreign firms can push up the average cost of production for the local firms and thus have a negative impact on the productivity of their local competitors. This can occur if the foreign firms take over significant market shares from local firms, in which case the local firms' fixed costs of production will be spread across fewer units. The firm's productivity will thus be lower when its market share is reduced (dis-economies of scale). Finally, increased competition for specialised labour and other key inputs to production may drive up prices and impact negatively on the productivity of local firms within and across industries.

Vertical linkages, arising via buyer-supplier relations between foreign firms and their local suppliers and buyers, can also lead to local productivity enhancements. However, if foreign firms source all their inputs from suppliers outside of the local market, and at the same time crowd out local competitors that *did* purchase inputs locally, they reduce the productivity among local suppliers via dis-economies of scale.

**Figure 6 Productivity spillovers via knowledge transfers and competition effects**



Note: The figures illustrate productivity spillover effects for different firms within the same regional industry. The upper figure illustrates the situation without FDI and the lower figure illustrates the situation with FDI. Firms are ranked according to their initial level of productivity, and the dotted grey line shows the average productivity for all firms in the industry before FDI. In the lower figure, FDI flows into the region as a foreign owned firm with a high level of productivity (illustrated by the black bar in the lower figure) establishes itself in the region. Local firms can learn from the foreign firm through knowledge transfers and thereby increase their own productivity (illustrated by the light blue bars). The foreign firm can also capture market shares from the least efficient local firms, which will be forced to close down, leading to a local industry restructuring (illustrated by the exit of the least productive firms). As a result, the average productivity of the remaining local firms increases (illustrated by the blue dotted line).

Source: ESPON FDI (2018) based on literature survey of FDI spillovers

Foreign owned firms can also have both a positive and negative impact on **employment** among local firms. A *negative* impact can arise if foreign owned firms crowd out local firms via competition in the final goods market (local competitors) or via competition for labour or other inputs (all firms regardless of industry affiliation). A *positive* impact can arise if foreign firms increase the demand for locally produced inputs or if local firms begin to export or increase existing exports because of their interactions with foreign owned firms.

*Finally*, if positive productivity spillovers materialise, local firms may find it optimal to reduce employment as they can support the same production with less workers. Over time, higher productivity will improve the competitiveness of the local firms and help them gain market share, domestically as well as internationally, which may cause employment to increase. Overall, the impact of foreign owned firms on the employment in local firms turns out to be ambiguous and we will address this question empirically.

### **2.3 Impacts of FDI on the productivity of local firms**

Geographic proximity reinforces the different spillover channels and is an important determinant of whether or not spillovers occur. *First*, as the geographical distance increases, labour mobility tends to be lower, and the scope of knowledge to ‘spill over’ from foreign to local firms will thus be reduced. *Second*, geographical proximity reduces transaction costs and facilitates communication, which makes it easier for a foreign firm to use local suppliers (vertical linkages and exporting) and for domestic firms to learn/copy from the foreign firm (imitation/demonstration). *Third*, competition between foreign firms and domestic firms may be stronger at the local level.

We have used solid econometric models to assess how the presence of foreign firms affects the productivity and employment of local firms across different regions.<sup>28</sup> The results indicate that FDI is associated with productivity gains among local firms within the same industry and region (intra-industry productivity spillovers) and within a given region more broadly (broader regional productivity spillovers) in most types of territories, cf. Table 3. Overall, we find that:

- Increasing the concentration of non-European owned firms within a given *industry and region* by one percentage point is associated with an average productivity increase of close to 0.5 per cent among local firms in the same industry and region.
- Increasing the concentration of non-European owned firms within a given *region* by one percentage point is associated with an average productivity increase of close to 2 per cent among local firms in the same region.

Our findings indicate that firms across all industries benefit more from productivity spillovers than firms within the industry. This shows that the knowledge inherent in the non-European firms does not only benefit local firms in the same industry, but benefits all local firms that

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<sup>28</sup> The methodology is described in more details in the scientific report, *Impacts of extra-European FDI towards Europe*.

engage with the foreign firm, e.g. local suppliers or local firms that hire employees from the foreign firm. This suggests that not only sector-specific knowledge may be transferred to local firms, but also more generally applicable knowledge such as e.g. managerial know-how.

Given that M&As account for 70 per cent of the total value of FDI inflows towards Europe, and that this type of FDI creates new jobs to a lesser extent than greenfield investments, we are interested in knowing if M&As are associated with positive spillovers to local firms. By combining different databases, we are able to identify a subset of non-European owned firms that we know were established in Europe through M&As. Our empirical analysis indicates that these M&As are associated with positive spillovers of a similar size as all other FDI projects.<sup>29</sup>

**Table 3 Productivity spillovers from non-European owned firms to local firms in the region**

	Productivity spillovers to local firms in the same industry (intra-industry spillovers)	Productivity spillovers to all firms in the region (broader spillovers)
All sectors and regions	0.5%	2.0%
Manufacturing sectors	0.2%	1.4%
Service sectors	0.8%	2.2%
Urban regions	0.4%	1.7%
Intermediate regions	-	1.4%
Rural regions	0.2%	-
Capital city metropolitan regions	-	1.0%
Other metropolitan regions	0.3%	1.6%
Non-metropolitan regions	0.2%	0.8%
More developed regions	0.3%	1.7%
Transition regions	0.2%	0.4%
Less developed regions	-	-

Note: The table summarises the findings related to productivity spillovers from non-European owned firms to local firms in Europe across the different types of territories. Local firms include both indigenous and European firms. More details can be found in the scientific report, *Impacts of extra-European FDI towards Europe*.

Source: ESPON FDI (2018) based on data from the Amadeus database

We find that productivity spillovers from non-European firms are generally larger for local firms in the service sectors than for local firms in the manufacturing sectors. The sub-sector analysis shows that this finding is mainly driven by large intra-industry productivity spillovers on local firms in the wholesale and retail trade sector as well as large broader regional productivity spillovers accruing to local firms engaged in accommodation and food services activities as well as in information and communication services. In the manufacturing sector, productivity spillovers mainly benefit local firms in the textiles, apparel and leather industries as well and the machinery industry.

<sup>29</sup> See the scientific report, *Impacts of extra-European FDI towards Europe* for a more detailed explanation of the data limitations that make it impossible to track how the existing non-European firms located in Europe were originally established.

Overall, we find that productivity spillovers are lower in rural and non-metropolitan regions, and even zero in the less developed regions. There could be several reasons for this. Local firms in these regions may not have the required resources and skills to benefit from knowledge spillovers from non-European owned firms. Similarly, local buyer-supplier linkages may not be sufficiently frequent or strong to generate spillovers across industries. Policies to improve the absorption capacity of local firms and the integration of non-European firms in the local economies will increase productivity spillovers, and such policies are particularly important in more less developed regions.

## **2.4 Impacts of FDI on the employment of local firms**

As described in Chapter 2, FDI can stimulate employment in a region through the number of jobs created *directly in the company* (in the case of greenfield investments) and through improved growth prospects of the local firms that have been taken over by a foreign multinational company (in the case of M&As). Inward FDI may also stimulate employment in the *other firms in the region* (indirect impact). In the short term, increased productivity may cause employment in the local firms to fall because the firms can support the same production with less workers. Over time, higher productivity will tend to improve the competitiveness of the local firms and help them gain market share – domestically as well as internationally – which will stimulate employment. Employment among local suppliers can also be stimulated by the presence of new and growing non-European owned firms, if the presence of these firms cause the demand for locally produced inputs to increase.

Respondents in the case studies generally have the perception that the direct and indirect impact on job creation in a region is positive and significant.<sup>30</sup> However, these job estimations rarely take into consideration that local firms who are in direct competition with the non-European owned firms may lose market share and adjust their production capacity, which means that jobs in the foreign firm to some extent reflect a replacement of jobs in local firms. If the new foreign firm furthermore uses fewer domestic suppliers than the local firm that is replaces, the indirect job creation will be negative and reduce the total number of jobs supported by FDI. These job estimations also fail to take into account that jobs in a non-European owned firm may also be more footloose than jobs in domestically owned firms.

As foreign firms are likely to affect employment among local firms both positively and negatively, we analyse the impact empirically and find no evidence to suggest that non-European owned firms affect employment levels among local firms.<sup>31</sup> This finding indicates that any positive and negative impacts (through reallocations and productivity enhancements) that foreign firms have on employment among local firms net out on average, which means that the jobs created directly in the foreign company do not merely replace jobs in local firms.

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<sup>30</sup> See the scientific report, *Case studies of best practices in FDI attraction*.

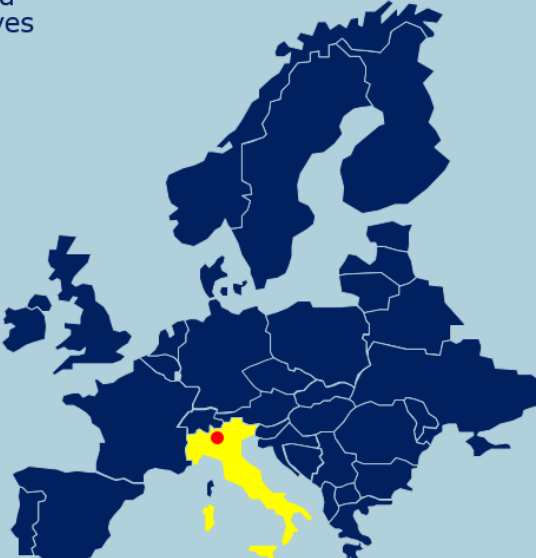
<sup>31</sup> See the empirical analysis in the scientific report, *Impacts of extra-European FDI towards Europe*.

Regions where foreign firms are well integrated in local supply chains and local firms absorb the knowledge inherent in the foreign firms easily, a positive impact on employment can be expected from FDI (unless there is no or little unemployment in the region). The Lombardy Region in Northern Italy is an example of a region where the competitiveness and survival of local firms have benefited from initiatives to attract FDI and strengthen regional development.

The most important mechanisms in place at the regional level include 'Dote Lavoro', 'Competitiveness Commitment' measures and 'AttrACT'. Dote Lavoro is a regional fund for hiring unemployed workers, new workers entering the labour market and other members of society with high risk of social exclusion. Competitiveness Commitment offers tailor-made step-by-step financial support (i.e. grants) to private companies. This initiative also makes it possible to engage in collaborations with local institutions and to 'access highly specialised skills and R&D infrastructure'. AttrACT aims at boosting competitiveness. Besides mapping investment opportunities and reducing bureaucracy, AttrACT offers concrete actions to facilitate investments, which include fiscal incentives such as reduced local taxes. It should also be mentioned that the Lombardy Region has a strong share of family businesses, which tend to keep managerial control and thus close doors to FDI or other forms of external intervention.

**CASE**  
**Italy: Lombardy Region**  
A predominantly urban to intermediate region, developed and with an advanced manufacturing sector. The region receives a majority of M&As.

- FDI has a large direct impact on the region
  - Supports job creation as well as attraction of talent and innovation
  - Boosts business competitiveness and survival of local firms
- The main sectors are manufacturing, ICT and financial and business services
- The strategy in attracting FDI focuses on a wide range of sectors with coordinated efforts between national and regional levels, including cutting red tape
- Main drivers for FDI to the region include
  - Good infrastructure and logistics facilities
  - Highly skilled labour force
  - Nine recognised industry clusters
- Constraint: Insufficient digital infrastructure outside provincial capitals as well as family businesses resist foreign investments



Source: ESPON FDI (2018). More details can be found in the scientific report, *Case studies of best practices in FDI promotion*

## 2.5 Concluding remarks

In this chapter, we have analysed the impacts of extra-European FDI flows towards Europe. Here, we distinguish between 1) the direct impacts of FDI in terms of the number, job creation and value added in the non-European owned firms located in Europe themselves, and 2) the possible productivity spillovers to local firms that improve the competitiveness and economic growth prospects of European firms. We analyse both types of impacts for the different groups of regions in order to assess the impact of FDI inflows on economic convergence in Europe. Overall, FDI will tend to support convergence if it flows mainly to less advantaged regions (such as rural, non-metropolitan and less developed regions) or if the impact of FDI in disadvantaged regions is larger than for more advantaged regions (such as urban, capital and more developed regions).

Overall, we find that the **direct impact** of FDI tends to be larger in more advantaged regions when we measure the direct impact in terms of number of FDI projects, the value of FDI inflows and the number of non-European owned firms. In Chapter 1, we found that FDI flows mainly to urban, capital and more developed regions (measured both in terms of number of FDI projects and their value). The concentration of FDI in the more advanced regions shows up in this chapter as a higher number of non-European owned firms in these regions. We also find that the firms that are located in the less advantaged regions tend to be smaller (measured both in terms of the number of employees and revenue) and that FDI projects in these regions have a smaller average deal value.

The composition of FDI is another way to measure the direct impact of FDI. Greenfield investments and expansions of non-European firms already located in a region are more likely to generate new jobs and revenue in the shorter term, whereas M&As to a larger extent can preserve jobs in a region and support growth in the longer term. In Chapter 1, we found that less advantaged regions perform particularly well in terms of attracting greenfield investments, which could indicate that the composition of FDI towards Europe supports economic convergence.

Looking across the different measures, our overall conclusion is that the direct impact of FDI appears to be smaller in less advantaged regions than other regions and, consequently, that the contribution to convergence from the direct impact is likely to be limited. FDI inflows into the transition regions do, however, seem to have had a large, direct impact on jobs and economic growth, which have stimulated convergence between the transition and more developed regions. These findings suggest that cohesion policy that supports initiatives to improve the investment climate can have a role to play in terms of stimulating more FDI into the less advantaged regions and in terms of scaling up existing non-European owned firms already located in Europe in order to increase the direct impact of FDI inflows (see policy recommendations later in the report). It should be noted, however, that the value to the regional economy of additional jobs or production may be larger in the less advantaged regions where existing business activities tend to be lower than in more advantaged regions.

M&As accounted for more than 70 per cent of the total FDI inflows towards Europe during 2003-2015, and this type of FDI flows mainly to the more advantaged regions with more developed business structures. For M&As to have a positive direct impact on economic development across the European regions, it is thus important that the foreign firms grow and continue to support jobs after the take-over. The change of ownership may spur growth in the firm (e.g. by conveying new leadership principles, insights about foreign markets and advanced technologies) and help build absorption capacity. The takeover may also inject new capital into the firm and ease capital shortages that constrained the firm's long-term survival and growth prospects. M&As may thus contribute positively to the regional economy by maintaining or even growing jobs within the firm and among potential local suppliers. However, the opposite may also be the case. Foreign-owned firms may be more footloose and likely to shut down in rough times. These firms typically have global supply chains which means that their strategic decisions (e.g. to expand and change suppliers) depend not only on local conditions but also on changes in other markets.

As described in the Lombardy case, FDI has literally brought back companies from the edge of bankruptcy by offering liquidity to the companies and introducing new management models. More research in this area could bring new knowledge about what happens to employment and revenue in the firms after take-over, and what can be done to preserve economic activity in the region.

The results from the empirical analysis indicate that FDI is associated with positive **productivity spillovers** to local firms within the same industry and region (intra-industry productivity spillovers) and within a given region more broadly (broader regional productivity spillovers) in the urban, capital metropolitan and more developed regions. In the Catalanian case, for example, the case study shows that foreign companies and workers bring new ideas and boost an 'innovative environment' and even a collaborative culture.

Productivity spillovers are lower in rural and non-metropolitan regions, and even zero in the less developed regions. These findings suggest that productivity spillovers should not be expected to spur convergence across regions. Policies to improve the absorption capacity of local firms and the integration of non-European firms in the local economies will increase productivity spillovers, and such policies are particularly important in the less advantaged regions. Again, it should be kept in mind that the spillovers that actually do materialise in less advantaged regions may be more effective in terms of improving competitiveness than spillovers in more advantaged regions.

Spillovers appear to be larger in the service sectors, particularly the broader regional productivity spillovers. This implies that spillovers are larger in the regions (e.g. the more developed, urban and capital regions) that attract a lot of FDI in services. Given the composition of FDI into Europe across sectors, with FDI in the manufacturing sector flowing mainly to the less advantaged regions, sectoral variations in spillovers from FDI do not seem to support convergence across territories in Europe either.



In the empirical analysis, we find no evidence to suggest that non-European owned firms affect employment levels among local firms. This finding suggests that any positive and negative impacts (through reallocations and productivity enhancements) that foreign firms have on employment among local firms net out on average, which means that the jobs created directly in the foreign company do not merely replace jobs in local firms.

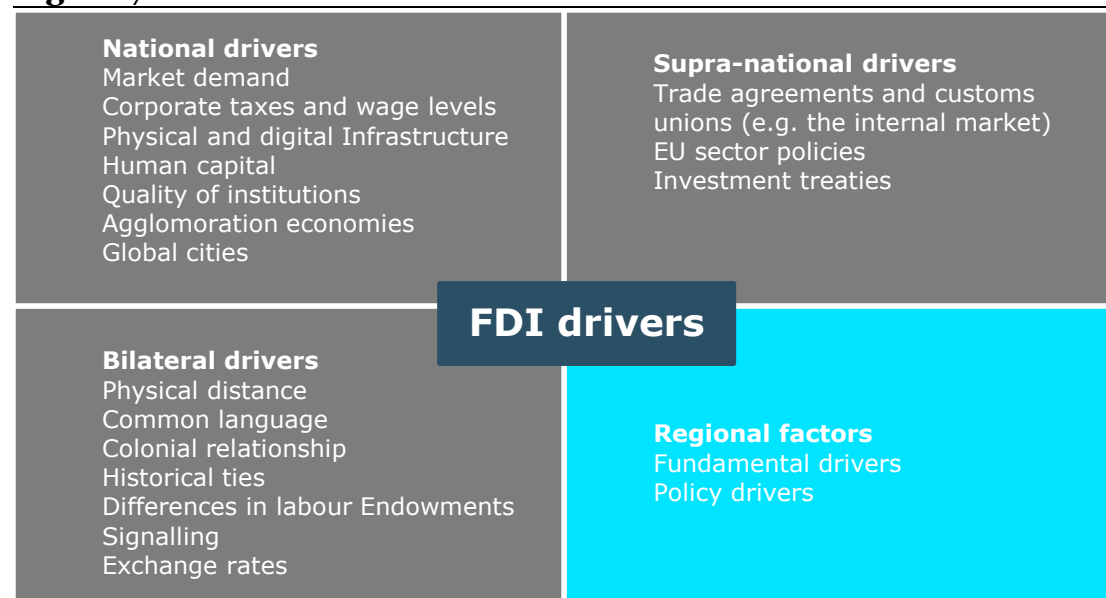
### 3 Drivers of FDI across European regions

The global macroeconomic situation influences the overall investment levels and the risk willingness of multinational firms, and global FDI flows dropped 39 per cent after the economic crisis (from 2007 to 2009).<sup>32</sup>

The distribution of global FDI flows across countries depends on a range of location-specific factors, and the drop in global FDI flows was unequally distributed across different groups of countries. Global FDI flows into Europe dropped by 53 per cent after the financial crisis, whereas FDI into the US dropped by only 36 per cent and FDI to the BRIC countries dropped by 6 per cent. Within Europe, the impact of the crisis was particularly severe for countries that are under the austerity measures (i.e. reductions in government spending, increases in tax revenues or both in order to lower deficits and avoid a debt crisis).

A wide range of factors go into the decision process of investing abroad, some of which will be specific to the firm and thus difficult to have general expectations about. However, studies across a large number of sectors and countries over time have provided a knowledge base about common factors that can help explain the location pattern of foreign firms. These factors may be determined at the national, supra-national (e.g. EU), bilateral or regional level, cf. Figure 7. In this chapter, we address the question: What factors determine FDI location across regions in Europe and how can local regulations affect the location choice of foreign investors?

**Figure 7 Overview of FDI drivers**



Source: ESPON FDI (2018) based on the literature survey in the scientific report, *Drivers of extra-European FDI towards Europe*

<sup>32</sup> A descriptive analysis of FDI flows into Europe can be found in the scientific report, *Trends and pattern in extra-European FDI towards Europe*. A comparison of intra-European and extra-European FDI can be found in the main report, *Intra-European FDI*.

We have analysed the location choice of non-European investors using the econometric model that has most frequently been applied in the empirical literature on FDI location. The methodology has been described in more detail in the scientific report, *Drivers of extra-European FDI towards Europe*.

### 3.1 Drivers of FDI across different types of regions

Overall, the empirical analysis shows that a number of regional drivers matter for the attractiveness of European regions towards non-European investors, cf. Figure 8 below. We categorise these as either policy FDI drivers or fundamental FDI drivers, where the former includes regional drivers that can be influenced by policy in the short to medium term, and the latter includes drivers that are more difficult for policy makers to influence within this timeframe.

We find that the policy FDI drivers that help attract non-European investors include strong industry clusters, labour abundance, and a higher share of the workforce with a tertiary education, good accessibility and a high level of innovation.

In terms of the magnitude of these drivers, ***the strength of industry clusters*** is the most important. Overall, we find that increasing industry clusters by one per cent increases the likelihood that a given FDI project is located in the region by 1.4 per cent, cf. Figure 8.<sup>33</sup> The reason why strong industry clusters matter is that a number of positive externalities arise when similar firms locate together, and these externalities make individual firms more productive. In areas with strong industry clusters, pools of specialised labour and inputs will thus often be available, and new ideas and innovation spread more easily across firms. The results show that strong industry clusters are especially important drivers of FDI for intermediate and rural regions as well as other metropolitan regions and less developed regions. There may be several reasons for these findings. Intermediate and rural regions attract a larger share of manufacturing firms (see Chapter 1), which are driven more by clusters than service firms are. In addition, local markets are less attractive and labour pools smaller in these types of regions than in urban regions with a higher population density. Firms locating here are thus likely to be looking for specialised labour.

***Labour abundance*** is the second most important policy FDI driver. Increasing the pool of available labour (measured as the regional unemployment rate) by one per cent increases the likelihood that a given FDI project is located in the region by 0.15 per cent. This factor matters because firms in some cases establish abroad to secure labour. A high unemployment rate signals to potential investors that there is abundant labour and that workers are likely to make

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<sup>33</sup> In the analysis, we measure industry clusters as the share of a region's employment in a given sector (2-digit NACE) relative to the country's employment in that sector. Strong industry clusters are therefore equivalent to a strong regional concentration of firms in the same sector. As sector affiliation is defined at the 2-digit NACE level (e.g. manufacturing of motor vehicles, trailers and semi-trailers), clusters can include both final goods producers (e.g. motor vehicles) and suppliers (e.g. parts and accessories for motor vehicles).

a greater effort to maintain their jobs. It should be kept in mind, however, that labour abundance will not always be a driver of FDI if the right skills and competences are not available. Labour abundance is more important in urban regions, capital metropolitan regions, other metropolitan regions and more developed regions where labour shortages can limit the firms' options for expanding their businesses.

Flexible labour laws can thus be tools to attract investments into these regions. Likewise, initiatives to improve the accessibility of urban centres from related rural territories can increase mobility and ensure that the necessary workers are available. It should be noted that such initiatives might support growth in both territories and thus spread out the benefits from FDI more equally across regions.

A higher share of the population with a **tertiary education** is also found to increase European regions' attractiveness towards non-European investors. Increasing the share by one per cent increases the likelihood that a given FDI project is located in the region by 0.12 per cent. Regions with a high level of education offer better access to human capital, which non-European firms in knowledge-intensive sectors may wish to access in order to improve their productivity. A high level of education is particularly relevant for urban regions, capital metropolitan regions, other metropolitan regions and more developed regions. This finding suggests that these types of regions tend to attract non-European owned firms, which place more emphasis on access to educated labour. Universities are also mainly located in urban, more developed regions, which may also help attract non-European owned firms seeking to gain access to highly educated labour.

It should be kept in mind that the skills of the labour force stretch beyond the level of tertiary education. The case studies of both Catalonia and Lombardy found that the most praised strength of these two regions is their highly skilled labour force, but that the emphasis is more practical and less academic. In particular, it is stated that "Lombardy's labour force has the unique opportunity to develop skills beyond the academic sphere through apprenticeships at any of the prominent industries in the region and research centres".<sup>34</sup>

Regional **accessibility** is slightly less important, but is still a significant driver of FDI.<sup>35</sup> Increasing this by one per cent increases the likelihood that a given FDI project will be located in the region by 0.04 per cent. Regional accessibility matters because it reduces the cost of transporting goods to and from the region, facilitates easier travel to and from the firm's headquarters, and enlarge the market by improving access to nearby markets. We find that

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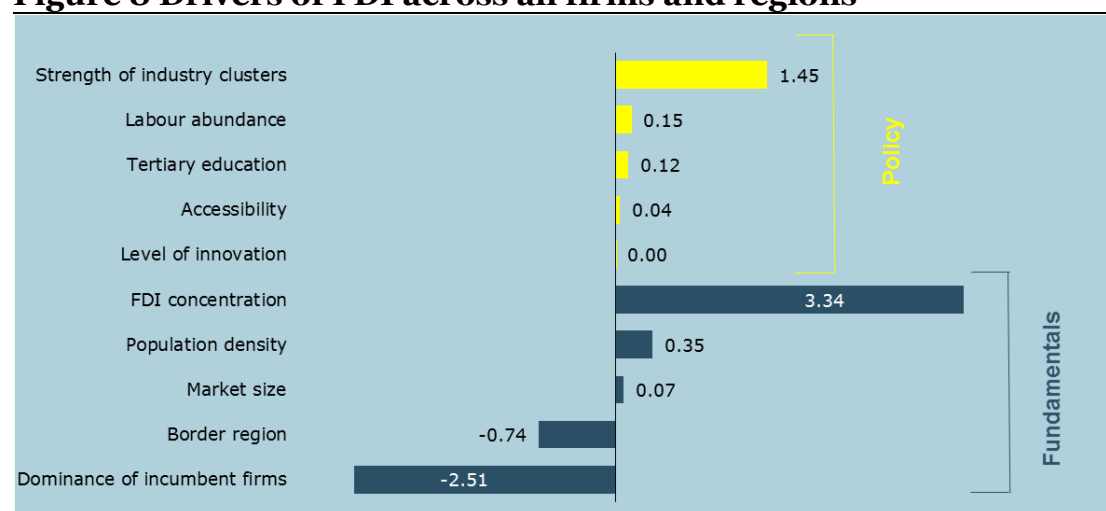
<sup>34</sup> From interview with Regione Lombardia.

<sup>35</sup> Regional accessibility is measured using the European potential accessibility index for freight, obtained from TRACC (2015). For each NUTS3 region, the index value is computed as the sum of GDP in all other European regions weighted by the generalised travel cost by multimodal (non-unitised), road, rail, air and/or water to go there.

accessibility is especially important for attracting non-European firms to capital metropolitan regions, where many headquarters are located, and ease of travelling is important.

Finally, a high **level of innovation** also makes European regions more attractive towards non-European investors, as the scope for acquiring new knowledge and hiring R&D workers will be greater. Firms that establish abroad in order to get access to such human capital resources will therefore be attracted to regions with a high level of innovation. The impact is however quite small across all types of regions, suggesting that the importance of regional innovation in terms of attracting non-European investors is limited<sup>36</sup> One explanation for this could be that the level of innovation is relatively high in most regions included in the analysis, which means that the level of innovation will contribute only a little to explain regional differences in FDI attractiveness. This may be due to the fact that innovation is measured via regional patent applications, which may not fully reflect the regional level of innovation. Another explanation is that the level of innovation in a region is also influenced by the national innovation level and therefore does not appear as a strong *regional* FDI driver. In addition, innovation can be important for some in a particular sector and of little importance to others, which means that the average impact will tend to be very small. Finally, the results could also indicate that the level of innovation has only recently become a determining factor for the location of foreign companies, which means that it may be more important for more recent investment patterns than the full-time period analysed in this study.

**Figure 8 Drivers of FDI across all firms and regions**



Note: The figure shows the results from the regression analysis conducted across the subset of all regions. The percentages shown in the figure are the change in the likelihood of a given FDI project being located in a given region, when the value of the respective regional driver is increased by 1 per cent (i.e. the average probability elasticity).

Source: ESPON FDI (2018) based on data described in the scientific report, *Drivers of extra-European FDI towards Europe*

<sup>36</sup> Increasing the level of innovation by one per cent increases the likelihood that a given FDI project is located in the region by 0.000251 per cent. In Figure 8, this is rounded off to zero.


We also find that a number of fundamental FDI drivers affect regional attractiveness. These include FDI concentration, population density, market size, border regions and the dominance of incumbent firms.

In terms of magnitude, the most important is **FDI concentration**. Increasing the number of foreign investors sends a signal of low risk and high profitability to other potential investors, and regions with a large stock of non-European firms will find it easier to attract even more FDI. The presence of non-European firms in the region sends a particularly strong signal to potential investors in less advanced regions. Investment promotion agencies in these regions can then benefit from making existing foreign firms more visible and using these business cases in their branding of the region. Overall, we find that increasing FDI concentration by one per cent increases the likelihood that a given FDI project is located in the region by 3.3 per cent. Across different types of regions, this driver is particularly important in urban, rural, less developed and non-metropolitan regions. In the latter three types of regions, this is likely due to a signalling effect as these types of regions may be less well-known for many investors. For urban regions, this finding also reflects that these regions are more attractive and tend to draw in more FDI.

The Nuremberg Metropolitan Region in Germany is an example of a region that benefits from the signalling effect of FDI. The region highlights the presence of a broad and strong industrial base that includes a number of non-European firms to brand itself and put the region on the map for potential foreign investors. The presence of international institutions, foreign communities and cultural exchanges do send a strong signal to potential investors as a sign of strong long-term ties with foreign investors.

**CASE**  
**Germany: Nuremberg Metropolitan Region**  
A polycentric metropolitan, non-capital region centrally located in Europe that mostly attracts M&As in the manufacturing sector.

- FDI has direct impact on the Nuremberg Metropolitan Region, generating
  - 2,550 jobs (between 2012-2016)
  - Strengthened clusters and position as a hub (e.g. in freight transport)
  - Knowledge spillovers to local firms
  - Branding of the region, cultural exchange and stimulates tourism
- The main sectors include the medicine, energy and production technology clusters
- Strategy in attracting FDI focuses on innovation, R&D and the present clusters
- The main drivers for FDI include
  - Central location in Europe
  - Good infrastructure and accessibility
  - Highest density of engineers in Germany
- Constraint: High corporate tax (30%) and competition with neighbouring regions (Munich and other German metropolitan regions)



Source: ESPON FDI (2018). More details can be found in the scientific report, *Case studies of best practices in FDI promotion*

The regional **population density** also influences the location decision of non-European investors, because a dense regional market means that firms can reach a large number of potential customers within a limited geographic range. This is of particular importance for market-seeking firms in the service sector, e.g. wholesale and retail activities. For other firms, a dense regional market will indicate high land and rent costs, which will tend to deter FDI. Overall, we find that the effect of population density is positive, but the impact varies across regions. Thus, while we find the population density to be an especially important driver of FDI into capital metropolitan regions and transition regions, we also find that a high level of population density deters FDI into urban regions.

A large regional **market size** offers good business opportunities and the potential for economies of scale, which attract non-European investors seeking new market opportunities (market-seeking FDI). An attractive regional market is a particularly important driver of FDI into more developed, urban and other metropolitan regions. This suggests that a higher share of FDI into these regions are likely to be market-seeking investments.

Regions with a high **dominance of incumbent firms** are less likely to host non-European owned firms. Highly dominant incumbent firms deter FDI in most types of regions but are of particular importance in urban, capital metropolitan, non-metropolitan and less developed regions. In the case of urban and capital metropolitan regions, this is likely due to a higher share of investments being market-seeking. If one of the main reasons non-European owned firms locate in these regions is to sell their products locally, dominant incumbent firms would reduce the market attractiveness. In non-metropolitan and less-developed regions, this could be likely due to increased competition for labour or other resources.

Likewise, **border regions** are on average disadvantaged because barriers to doing business across borders limit the size of the local market.<sup>37</sup> Initiatives to reduce such barriers (e.g. disparities and differences in legal, social and political systems) will help these regions attract more FDI. Looking across types of regions, we find that the negative impact is driven by urban regions, whereas capital metropolitan regions can, in fact, benefit from being a border region.

Greater Copenhagen is a best-practice example of how cross-border collaboration can benefit both sides of the border. The region offers world-class research facilities and a creative business environment with access to the markets of two countries. However, different rules and regulations hinder labour market integration – particularly for non-EU citizens. To address this challenge, Copenhagen Capacity, in cooperation with Invest in Skåne, has attempted to establish an internal *division of labour between* the two regions based on their competitive advantages (e.g. Sweden – automotive sector, biogas sector, packaging, ICT; Denmark – life

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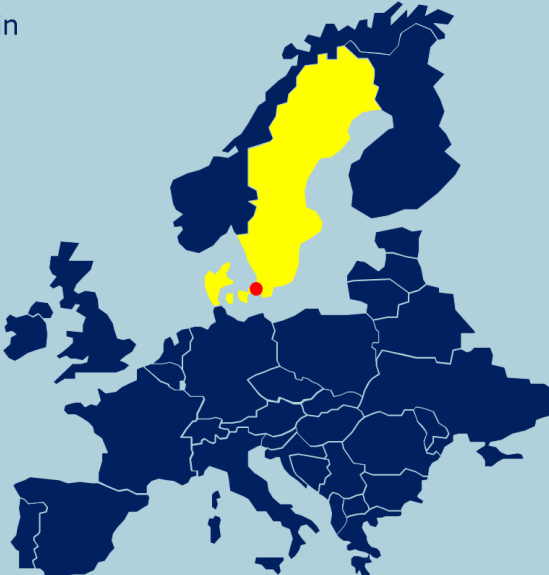
<sup>37</sup> The border variable has been provided by DG Regio and takes the value 1 if the region's population lives within a 25 km buffer zone along a land border. A more detailed description of this variable and the other data used in the empirical analysis can be found in the scientific report, *Drivers of extra-European FDI towards Europe*.

science, clean tech.). In addition, a law has been passed that allows researchers working in the European Spallation Source to live and work in both countries.

**CASE**  
**Denmark & Sweden: Greater Copenhagen Region**

A predominantly metropolitan, capital and urban region with a high level of development that has been successful in attracting FDI (mostly greenfield) to a region spanning national borders.

- FDI creates new high-productivity jobs in the region with foreign firms generating
  - 20% of jobs and value added
  - 25% of private sector exports
  - 904 new jobs in 2015 with 597 indirect jobs in local companies
  - Knowledge spillovers to local firms
- The main sectors are life science, clean and green tech and ICT
- The FDI strategy focuses on attracting R&D and innovation investments in niche markets through cross-border collaboration and clear integration with national and regional development goals
- The main drivers for FDI include
  - Cross-border clusters
  - Centrally located in the Nordics
  - High level of digitalisation
  - High security and political stability
- Constraint: High costs of both set-up and ongoing operations (particularly salaries)

A map of Europe with the Greater Copenhagen region, spanning parts of Denmark and Sweden, highlighted in yellow. A red dot is placed on the map, likely indicating the location of the European Spallation Source.

Source: ESPON FDI (2018). More details can be found in the scientific report, *Case studies of best practices in FDI promotion*

The FDI drivers for different groups of regions are summarised in Figure 9.



**Figure 9 Drivers of FDI across different types of regions**

	Regional drivers	Impact	Significant for...
Policy FDI drivers	Strength of industry clusters	+	All regions, but especially important for intermediate regions, rural regions, other metropolitan regions and less developed regions
	Labour abundance	+	All regions, but especially important for urban regions, capital metropolitan regions, other metropolitan regions and more developed regions
	Tertiary education	+	All regions, but especially important for urban regions, capital metropolitan regions, other metropolitan regions and more developed regions
	Accessibility	+	All regions, but especially important for capital metropolitan regions
	Level of innovation	+	All regions, but the effect is very small
Fundamental FDI drivers	FDI concentration	+	All regions, but especially important for urban regions, rural regions, non-metropolitan regions and less developed regions
	Population density	+ / -	All regions (positive), but especially important for urban regions (negative), capital metropolitan regions and transition regions (positive)
	Market size	+	All regions, but especially important for urban regions, other metropolitan regions and more developed regions
	Border region	- / +	All regions (negative), but especially important for urban regions (negative), capital metropolitan regions (positive) and more developed regions (negative)
	Dominance of incumbent firms	-	All regions, but especially important for urban regions, capital metropolitan regions, non-metropolitan regions and less developed regions

Note: The figure summarises the findings from the FDI driver analysis. The green plus signs indicate that higher values of the regional driver is associated with a higher likelihood of a non-European owned firm being located within the given region, while a red minus sign indicates the opposite.

Source: ESPON FDI (2018) based on the econometric analysis in the scientific report, *Drivers of extra-European FDI towards Europe*

Besides these regional FDI drivers, we have also tested the importance of the allowance for financial investment incentives. As data on this variable is only available for a limited number of countries and regions, we have tested the importance of this driver in an extended model.

We find that regions that allow for the use of **financial investment incentives** are more likely to host foreign firms than regions where such incentives are not allowed. As the regions in which investment incentives are allowed are ones that lag behind relative to either the rest of the EU or relative to other regions within the country, these results indicate that the use of investment incentives can stimulate convergence across European regions, cf. Figure 10. The results are, however, only indicative as we do not know to what extent such investment incentives are actually being used in the regions. In addition, we do not know if this is an efficient and sustainable way of increasing FDI into these regions, particularly since the impact is relatively small.

The conclusion from the case studies is that, while financial incentives may act as a ‘cherry on top’, they cannot substitute for, among other things, good macroeconomic fundamentals, the availability of physical and communication infrastructure, and political stability.

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## Figure 10 FDI regional incentives

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Within the EU, financial and fiscal investment incentives to attract FDI such as direct grants, cost-sharing schemes, reduced rates or direct provision of land, tax exemptions or reductions given to specific firms are considered a form of state aid. The use of such incentives is therefore governed via a framework of wider laws on state aid. The framework allows for the use of such incentives at varying degrees in two types of regions, stipulated in the two articles of the Treaty on the Functioning of the European Union (“TFEU”):

1. ‘a’ areas – Article 107(3)(a): NUTS2 regions with a gross domestic product (GDP) per capita in purchasing power standards (PPS) that is equal to or less than 75% of the EU27 average and outermost regions.
2. ‘c’ areas – Article 107(3)(c):
  - Predefined ‘c’ areas: Areas fulfilling pre-established conditions that can be designated by Member States without any further justification; this category includes NUTS2 regions that were designated as ‘a’ areas in the 2011-2013 period and sparsely populated NUTS2 and NUTS3 regions, as well as parts of or areas adjacent to NUTS3 regions, under certain conditions.
  - Non-predefined ‘c’ areas: Areas that may be designated by a Member State provided that they fulfil certain socio-economic criteria.

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Source: ESPON FDI (2018) based on European Parliament (2017)

### 3.2 Drivers of FDI across sectors, origins and types of FDI

We have also used the econometric driver model to analyse if the FDI drivers differ across sectors (services and manufacturing), origin of the investors (US, Russian and other origins) and type of FDI (M&A and all FDI). Investment promotion agencies can use insights from this analysis in their branding campaigns and in targeting their communication to different groups of potential investors. In this context, taking territorial characteristics, drivers and impacts into account when developing policy will increase the effectiveness of such investment promotion activities.

We find that industry clusters are particularly important for the location of non-European owned firms in the **manufacturing sector**, whereas the regional market size does not seem to be an attraction factor. Firms in the manufacturing sector thus locate more where there is industry-specific knowledge and labour.

Within the **service sector**, the level of education, labour abundance, the regional market size, population density and the presence of other non-European owned firms are particularly important for the location of non-European owned firms. Firms in the service sector are more driven by an attractive local market in terms of high demand and a large pool of qualified labour. Besides signalling an attractive investment climate, a high FDI concentration indicates that

there is high demand for business services, which makes the region even more attractive for firms in the service sector. The high importance of the local market also explains why border regions and regions with highly dominant incumbent firms are less attractive for investors in the service sector. Border regions are less attractive because cultural differences, different languages and border barriers limit the size of the local market. Likewise, the scope for doing business and gaining market share is lower when there are highly dominant competitors in the region.

In terms of the origin of investments, we find that the US (20 per cent) and Russia (18 per cent) are the main sources of extra-European into Europe. With only a few exceptions, we find that FDI from different origins tends to be driven by the same regional factors.

**US investors** are particularly attracted to regions with large regional markets, particularly in the UK and Ireland due to the common language and shared history. As the underlying motive for US investors to locate in Europe is to serve the local markets, regions with a high dominance of incumbent firms are less attractive to these investors.

**Russian investors** are particularly attracted to regions with good accessibility and labour abundance, whereas the regional market size has little importance. In fact, Russian firms tend to locate in smaller regions (particularly in the new EU Member States) which they use as production platforms for exports to other markets in Europe. Russian investors respond more strongly to signals from other foreign firms about the attractiveness of a particular region, and a high concentration of other non-European owned firms may offer a potential for Russian investors to tap into European supply chains and expertise.

In terms of the type of investment, a larger regional market size and stronger industry clusters are particularly attractive to investors engaging in **M&As**. This is most likely because there is a larger pool of potential target firms available in regions with larger markets and strong industry clusters. It has not been possible to identify factors that are of especial relevance to the location of greenfield investments.<sup>38</sup>

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<sup>38</sup> See the scientific report, *Impacts of extra-European FDI towards Europe* for a more detailed explanation of the data limitations that make it impossible to identify greenfield investments and thus test if the drivers differ from other types of FDI.

**Figure 11 Drivers of FDI across sectors, origins and types of FDI**

	Regional drivers	Impact	Significant for...
Policy FDI drivers	Strength of industry clusters	+	All non-European firms, but especially in manufacturing and for M&As
	Labour abundance	+	All non-European firms, but especially in services and for Russian investors
	Tertiary education	+	All non-European firms, but especially in services
	Accessibility	+	All non-European firms, but especially for Russian investors
	Level of innovation	+	All non-European firms, but the effect is very small
Fundamental FDI drivers	FDI concentration	+	All non-European firms, but especially in services and for Russian investors
	Population density	+	All non-European firms, but especially in services
	Market size	+ / -	All non-European firms, but especially in services, for US and other non-Russian investors and for M&As (positive). Negative in manufacturing and for Russian investors
	Border region	-	All non-European firms, but especially in services, and for Russian investors
	Dominance of incumbent firms	+	All non-European firms, but especially in services and for US investors

Note: The figure summarises the findings from the FDI driver analysis. The green plus signs indicate that higher values of the regional driver is associated with a higher likelihood of a non-European owned firm being located within the given region, while a red minus sign indicates the opposite.

Source: ESPON FDI (2018) based on the econometric analysis in the scientific report, *Drivers of extra-European FDI towards Europe*

### 3.3 The FDI attractiveness of European regions

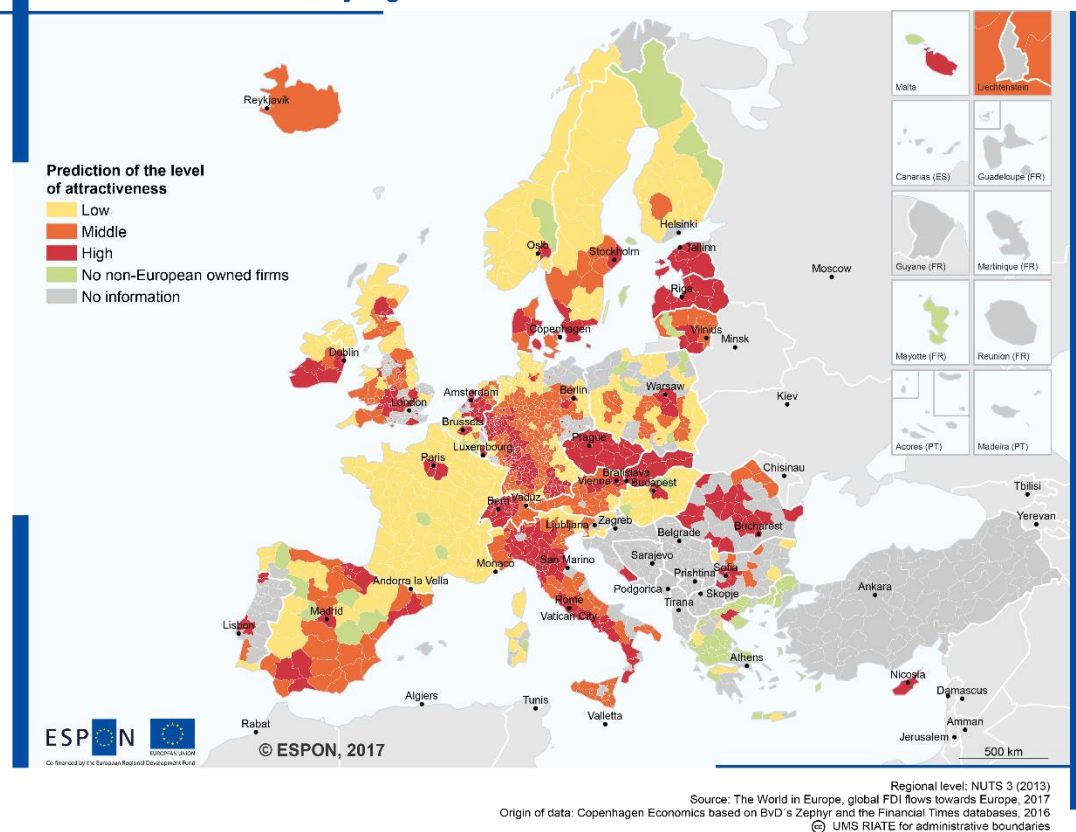
The econometric model applied in the driver analysis can be used to assess the attractiveness of individual regions in Europe relative to an average European region based on the regional characteristics (policy drivers as well as fundamentals).<sup>39</sup> Taking national and regional drivers into account, we find that the most attractive regions are located in a number of countries in both the all parts of Europe, cf. Map 5. The capital metropolitan regions and their neighbouring regions are generally more attractive, which suggests that these types of regions have some inherent characteristics that attract FDI relative to other types of regions. This makes it difficult to compare individual regions with an average region – capital metropolitan regions will usually appear more attractive than urban regions. In this study, we therefore compare the attractiveness of a capital metropolitan region with other capital metropolitan regions, urban regions with other urban regions, transition regions with other transition regions, etc. Peer-to-peer comparisons change the relative attractiveness of regions significantly. In the case of

<sup>39</sup> See the scientific report, *Drivers of extra-European FDI towards Europe*.

France, for example, the majority of regions outside of the capital and its surrounding regions are rural or intermediate regions and therefore relatively unattractive when compared to urban regions. However, relative to their peers (other rural and intermediate regions, respectively), a number of regions outside of Paris are now in the 'Middle' group, underlining the importance of comparing like with like.<sup>40</sup>

## Map 5 The FDI attractiveness of European regions, 2015

### Predicted attractiveness by region in 2015



Note: The attractiveness of individual regions is measured as the predicted values from the econometric model applied in the driver analysis. The category 'High' attractiveness includes the third most attractive regions, and the category 'Low' includes the third least attractive regions. The category 'Middle' includes the remaining regions. The attractiveness of a region is measured relative to the average attractiveness of all regions taking both national and regional drivers into account.

Source: ESPON FDI (2018) based on the scientific report, *Drivers of extra-European FDI towards Europe*

### 3.4 Concluding remarks

Overall, the results show that there are some common factors that increase the attractiveness of European regions towards non-European investors, and policy initiatives addressed to these factors should be expected to increase FDI inflows:

<sup>40</sup> See the scientific report, *Drivers of extra-European FDI towards Europe*.

- In terms of magnitude, **the strength of industry clusters** is the most important, and initiatives to strengthen existing clustering or building new clusters around existing strengths will stimulate FDI inflows.
- **Labour abundance** and a higher share of the population with a **tertiary education** are also important FDI drivers. Initiatives to build a competitive skills base and attract foreign talents to the region are not only likely to attract more FDI but will also increase the absorption capacity in the region and enhance the potential for positive productivity spillovers. At the national level, initiatives to ensure labour market flexibility and integration are likely to stimulate FDI inflows.
- Regional **accessibility** is also an indicator of FDI attractiveness, and investments in accessibility can reduce transportation cost, ease travelling and improve (physical and digital) connectivity.
- A high **level of innovation** also makes European regions more attractive to non-European investors, as the scope for acquiring new knowledge and hiring R&D workers will be greater. The size of the impact measured is quite small, and we find that further research in the importance of innovation as a driver of FDI towards Europe would be useful.
- A high **FDI concentration** sends a signal of low risk and high profitability to other potential investors, and regions with a large stock of foreign firms will find it easier to brand themselves internationally and attract even more FDI.
- The regional **population density** and **market size** also attract foreign investors, but these drivers are difficult for regional policy makers to influence in the short to medium term. At the EU level, initiatives to reinforce the Single Market, mitigate the negative impacts of Brexit and stimulate economic growth will make Europe more attractive for non-European investors relative to other locations.
- **Border regions** are, on average, disadvantaged because barriers to doing business across borders limit the size of the local market. Initiatives to reinforce the Single Market and integrate Europe globally will tend to reduce the importance of borders within Europe.
- Regions with a high **dominance of incumbent firms** are less likely to host non-European owned firms, and the implementation and enforcement of efficient national competition policies will make it more attractive for non-European owned firms to establish themselves in the country.

We also find that the strength of industry clusters and FDI concentration are particularly important for **rural, non-metropolitan** and **less developed regions**. Clusters are also important for the location decision of firms in the manufacturing sector, and the analysis in previous chapters has shown that FDI in this sector flows more frequently to the less advantaged regions than FDI in other sectors. The case studies show that developing sectoral ecosystems requires the engagement of a number of government departments to enhance the business environment, as well as collaborative firm-level initiatives that bring together different cohorts of companies and the research community. Initiatives to ensure efficient collaboration between different layers of public administration are particularly important for the less advantaged regions. The analysis in previous chapters indicates that foreign firms are less prevalent in these regions, which could deter new foreign firms from locating in the region.

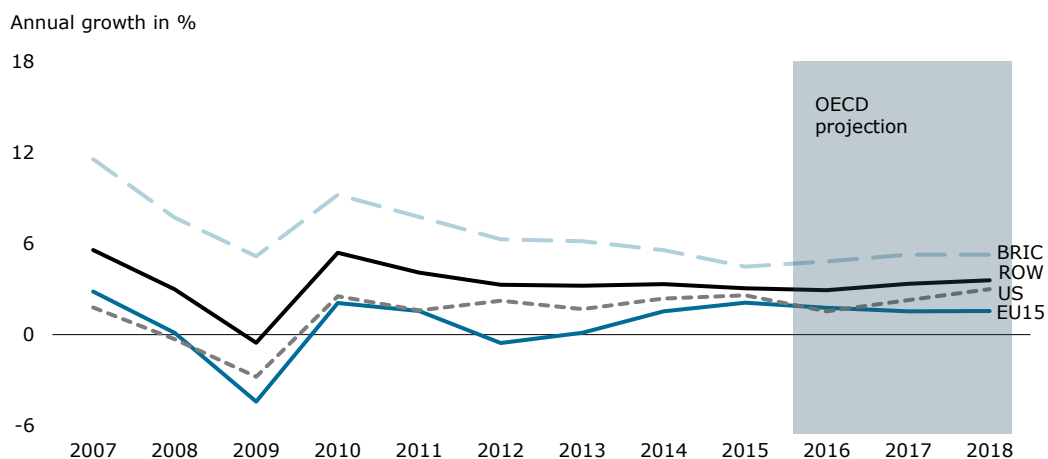
There could thus be an argument for using **financial incentives** to overcome rigidities in the way foreign firms locate.

It is important to notice that there may be issues related to interdependencies between the FDI and sequencing of initiatives that should be taken into consideration. Investments in accessibility, for example, may be a prerequisite for benefitting from initiatives to build strong industry clusters but may convey little impact on their own. These issues have not been addressed in this analysis.

## 4 The way forward

As barriers to cross-border trade and investments, both within the EU and worldwide, have been dismantled during the past two decades, worldwide competition for attracting multinational firms has intensified. Investors have historically been attracted to the EU due to its large market size, the high degree of stability and the skilled labour force.<sup>41</sup> Before the crisis, the EU was the destination for almost half of global FDI flows, but the EU share was only around 25 per cent in 2015.<sup>42</sup> An important driver for the shift in global FDI flows is the opening up of new emerging markets with high economic growth, light regulation and more active use of state aid than the EU. The low growth prospects illustrated in Figure 12 thus make Europe a less attractive location for FDI than the US or the BRIC countries

**Figure 12 Growth projections in and outside Europe**



Note: EU15 contains the 15 Member States prior to the 2007 expansion. Only data on 23 EU member states are available from OECD. BRIC is *Brazil, Russian Federation, India and China*, ROW is *rest of the world*. Comparable numbers are only available from 2007.

Source: ESPON FDI (2018) based on OECD Economic Outlook

Much can still be done by European policy makers to reverse the downward trend in the share of global FDI. Here, it should be noted that most of the policies that make it more attractive for non-European investors to establish or expand business in Europe will also stimulate investments by domestic firms and intra-EU FDI, which will improve the competitiveness and growth prospects for Europe. It is thus important to enhance the investment climate for *all* firms – local, European and non-European. In this chapter, we address the questions: What policy measures can be implemented to attract FDI and to boost the competitiveness of the European regions?<sup>43</sup>

<sup>41</sup> E&Y (2015) *EY's attractiveness survey: Europe 2015 – Comeback time*.

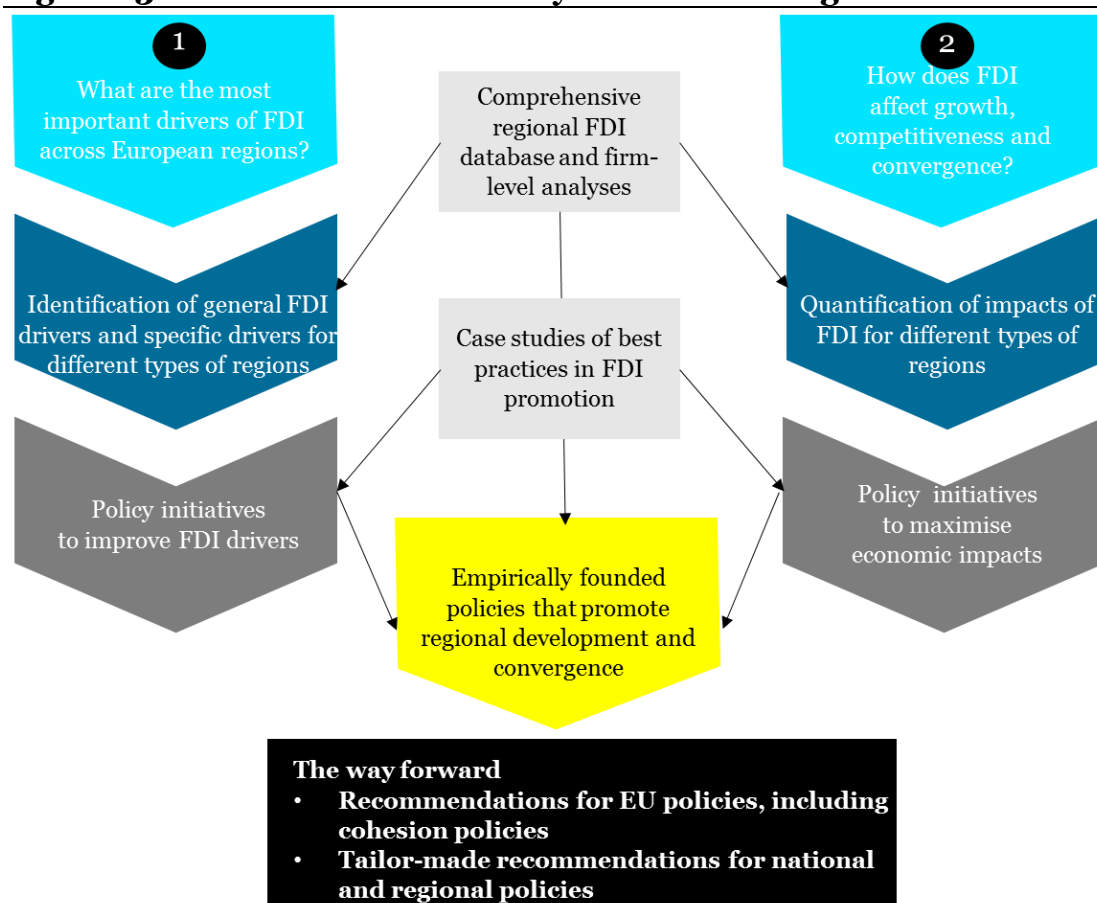
<sup>42</sup> UNCTAD (2016) *World Investment Report 2016*.

<sup>43</sup> In the quantitative analyses carried out throughout this study, we have attempted to include as many European countries and regions as possible. However, data on FDI flows and drivers for the EU Candidate



Our recommendations are based on solid econometric models with insights from a new database on regional FDI flows and detailed case studies on best practices in FDI promotion. The overall purpose is thus to identify initiatives that 1) can help stimulate increased FDI inflows into Europe and 2) increase benefits from FDI inflows. This is illustrated in Figure 13.

**Figure 13 How the combined study offers new insights**



Source: ESPON FDI (2018)

#### 4.1 A place-based approach is required

The regional diversity in Europe where regions have different territorial characteristics, opportunities and needs, requires going beyond a “one size fits all” strategy for FDI attraction. In fact, the findings in this study suggest that it is the combination of the attractive investment climate created by the EU, national and regional policies and the application of unique “best practices” strategies fitted to the regional context that have stimulated FDI inflows in successful regions.

Countries (The former Yugoslav Republic of Macedonia, Turkey and Montenegro) and the other countries of the Western Balkans (Bosnia & Herzegovina, Serbia, Albania and Kosovo) are relatively scarce. Therefore, the conclusions and policy recommendations cannot be extended to these countries without further analysis.

The place-based approach to FDI attraction is thus in line with the Smart Specialisation approach introduced by the European Commission. In attempting to replicate success from other regions, policy makers should carefully consider existing regional characteristics and specific strengths and weaknesses of the region. This place-based approach to FDI promotion appears clearly from the case studies of best practices.

FDI is not a goal in itself. It is the value it creates for local firms and citizens that concerns policy makers. A *first element* in a place-based approach to FDI promotion is therefore a mapping of the economic structure, comparative advantages as well as growth drivers and restraints in the region. The purpose of the mapping is to identify the region's needs, which will vary from region to region. Job creation may be a key concern in one region, whereas lack of qualified labour limits growth in another. Capital may constrain private firms' scale-up opportunities in one region, whereas lack of entrepreneurship limits the number of firms in another. The mapping can be used to develop a regional development strategy with concrete actions that can stimulate economic development in the region going forward. Some of the needs are specific to the region, whereas other needs are national. It is therefore important that the regional development strategy builds on and is aligned with national strategies.

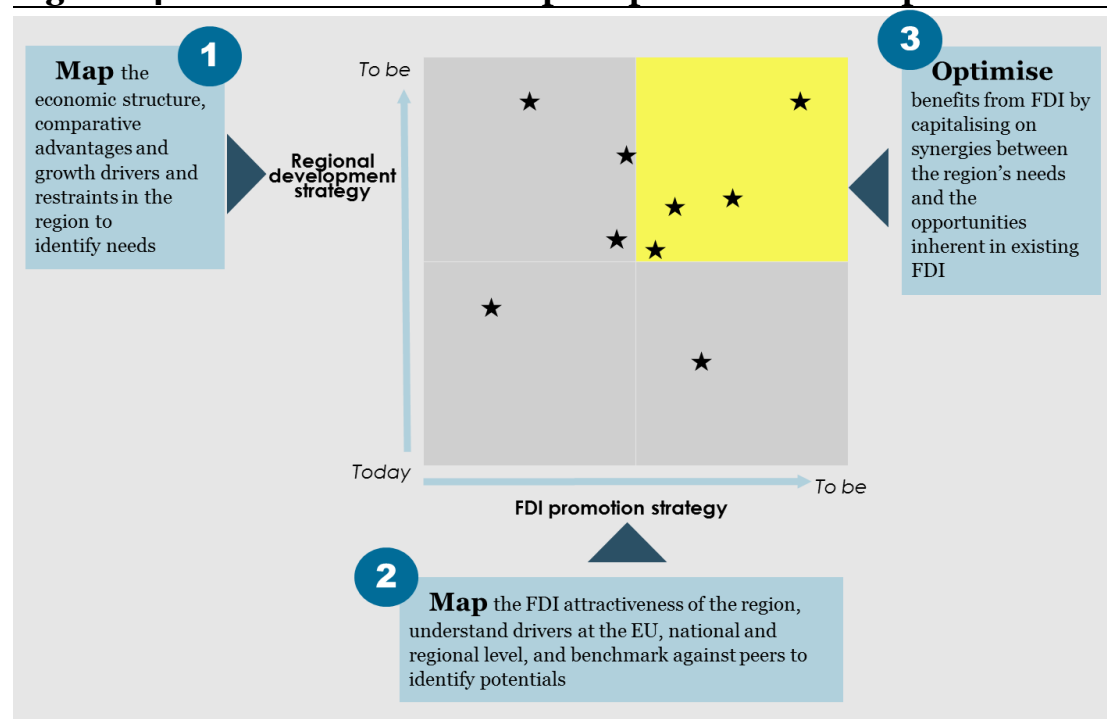
A *second element* is a mapping of the FDI attractiveness of the region. Understanding the drivers of FDI across sectors, types of FDI, and territorial contexts makes it easier for policy makers to develop high-impact FDI promotion initiatives, and benchmarking the region against peers on these drivers of FDI will help reveal potentials. FDI drivers can be influenced at both the EU, national and regional level. In the following sections, we have used the quantitative and qualitative analysis carried out in this study to identify some policy initiatives to increase FDI inflows that may give inspiration to policy makers at all levels. The mapping of strengths and weaknesses and the identification of FDI potentials can be used to develop a FDI promotion strategy with concrete actions that can spur FDI inflows into the region.

A *third element* is optimising benefits from FDI inflows by capitalising on synergies between the region's needs and the opportunities inherent in the FDI inflows to the region. Synergies could relate to the regional value chains, where more integrated value chains can both stimulate economic development in the region and strengthen industry clusters that make the region attractive for new investors. Synergies could also relate to after-care support and stakeholder involvement in policy development that can make it more attractive for existing foreign companies to expand in the region and thereby support even more jobs. Below, we have used the case studies to identify some policy initiatives to increase benefits from FDI inflows that may give inspiration to regional policy makers.

These elements in a place-based approach to FDI promotion are illustrated in the road map in Figure 14. It is important to emphasise that it is up to the individual region to put these elements into their own context and add relevant aspects of FDI promotion that fit the specific characteristics of the region. It should also be emphasised that the effectiveness of certain initiatives in some cases hinges on the implementation of other initiatives. Infrastructure

investments that improve the physical accessibility of a region, for example, are more likely to attract foreign companies looking for ways to optimise their value chains if initiatives to strengthen value chains in the region, streamline border procedures and cut red tape are implemented simultaneously.

**Figure 14 Elements in a road map for place-based FDI promotion**



Note: The stars are illustrative and represent different initiatives, which the regional authorities can consider implementing. "Today" is the current situation, whereas "To be" reflects the expected situation once new initiatives have been implemented. Stars in the upper right corner reflect initiatives that support both the implementation of the regional development strategy and the FDI promotion strategy.

Source: ESPON FDI (2018) based on the quantitative and qualitative analyses carried out in this study

## 4.2 EU policies to attract more FDI into Europe

FDI occurs in a rapidly evolving global economy that involves increasingly interconnected and complex value chains. EU policies that make it easy for non-European firms to establish themselves in Europe and do business across borders will stimulate FDI inflows. The European Commission has no targeted framework for FDI (which is considered national sovereignty) but rather for private investments as a whole. The *Investment Plan for Europe to strengthen Europe's competitiveness and to stimulate investment for the purpose of job creation*, for example, aims at improving the investment climate in Europe.

Many of the initiatives to support private investments in Europe will also support FDI inflows:

- **Reinforce the Single Market.** The Single Market offers access to 500 million high value consumers and is thus a huge attraction factor for non-European firms seeking business opportunities abroad. Initiatives to strengthen the Single Market will stimulate FDI inflows towards Europe. Such initiatives could include a digital single market, an energy union or a capital markets union as described in the Juncker Plan.

- **Ensure political, regulatory and legal predictability.** FDI typically involves large fixed investments (e.g. in buildings, production plants and equipment), and investors are therefore sensitive to any factors that cause a risk to their investment. A stable political, regulatory and legal environment reduces the risk of undertaking FDI in Europe (particularly in light of Brexit). For cross-border investments, investor protection secured by EU investment treaties is of particular importance.
- **Integrate Europe globally.** EU transport policies that improve accessibility to and from Europe will give firms placed in Europe better opportunities to optimise their global value chains, and this will make it more attractive for non-European firms to locate in Europe. Likewise, accessibility to foreign markets ensured by EU trade agreements will also make Europe a more attractive location for multinational firms with global operations and client bases.
- **Support sustainable growth.** EU policies can support job creation, business competitiveness, economic growth, and sustainable development, and improve citizen's quality of life. Such initiatives include cohesion policies and initiatives to improve competitiveness, such as research and innovation, education and training, trans-European networks, social policy, economic integration and accompanying policies.<sup>44</sup> Sustainable growth throughout Europe will make Europe as a whole more attractive for firms looking for new business opportunities abroad.

### 4.3 National policies to attract more FDI into European countries

There are several preconditions that are necessary for any region to attract and maintain foreign investments. These factors include both fundamentals (demand, quality of institutions, concentration of foreign firms and global cities) that are difficult for policy makers to influence in the shorter term, and policy variables (tax rates, wage levels, physical infrastructure, human capital, clusters and cost of location) that can be changed more easily. The combined results from the literature survey<sup>45</sup> and the case studies carried out in this study point to the following recommendations at the national level:

- **Ensure efficient collaboration between different layers of public administration.** High-quality institutions (e.g. stable politics, legal certainty, clear timeframes, low corruption and conditions that support personal security) are of overarching importance for a country's attractiveness. In *smaller countries*, regional FDI policies are in many cases largely determined by national policies, and the regional FDI promotion agencies focus mainly on generating an eco-system around regional strengths, coordinating skill shortages and collaborating with private firms. In *larger countries*, more autonomy is typically granted to the regional unit, and the region has the potential to build a broader industrial base to attract FDI. Here, it is important that the agility of the regional unit is not compromised by unclear timeframes and rules at the national level as well as duplication of responsibilities at different governance levels. The case studies show that in the

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<sup>44</sup> See [http://ec.europa.eu/budget/explained/budg\\_system/fin\\_fw0713/fin\\_fw0713\\_en.cfm](http://ec.europa.eu/budget/explained/budg_system/fin_fw0713/fin_fw0713_en.cfm) for more information about the EU budget and composition of current expenditures.

<sup>45</sup> The literature survey can be found in the scientific report, *Drivers of extra-European FDI towards Europe*.

countries where this is a problem, various “one-stop-shops” for new investors have proven valuable (e.g. in Lombardy and Catalonia). Some examples of how this collaboration is organised in practice have been provided in the box below.

## Examples of collaboration in practice

For instance, the **Greater Copenhagen** Region’s approach to FDI is clearly integrated with national and regional development goals with its central focus on attracting R&D and innovation investments in niche markets. These goals/objectives chart a course for future development and are used by the regional investment promotion agencies as a roadmap to sharpen the focus of their investment attracting activities. There is a one-to-one correlation between the Capital Region of Denmark and Copenhagen Capacity: The politicians set the overall framework whereas the Investment Promotion Agency (IPA) operationalises objectives and hence regional (and national) policies.

In the case of **the Netherlands**, industry-specific, targeted investment incentives have long been a tool of Dutch economic policy to facilitate regional development, R&D and other national socioeconomic goals. The government has instituted a preferential policy in a joint effort with academia and the private sector, whereby over USD 1 billion of additional funding is released for R&D and product innovation in the top sectors. Although much coordination of investment support is performed at the ministry-level and by the Netherland’s Foreign Investment Agency (NFIA), several regional development agencies also participate in guiding both businesses and local authorities on the best use of regional development funds.

In **Nuremberg**, the strategy is the product of a regional, multi-level governance structure that includes the economic, business, scientific and politic sectors that establishes the guidelines for the economic, technological and scientific orientation of NMR. The strategy establishes the overall framework and promotes the intensification and expansion of regional value chains and innovations.

**Lombardy** has established a good vertical coordination with the Italian Trade Agency to promote investments abroad. **Catalonia, on the other hand**, has taken on board the task themselves, and opened up 39 offices in foreign countries to promote investments abroad.

Source: ESPON FDI (2018) based on the scientific report, *Case studies of best practices in FDI promotion*

- **Use financial incentives selectively.** The use of financial investment incentives could be a way forward for disadvantaged regions with a low presence of foreign firms to start building up a stock of foreign firms in the region. The strong signalling effect suggests that there are certain rigidities in the way that foreign investors locate, and investor incentives may help break the vicious cycle for some regions. To have a large impact, it is important that such incentives are used selectively and are adjusted to the regional context, and that the incentives do not discriminate against local firms. The case studies show that investor incentives are generally perceived as a “cherry on top” and cannot compensate for an unattractive investment climate. A summary of some key findings related to financial incentives are summarised in the following bullet points.
- **Ensure labour market flexibility and integration.** Flexibility in the labour market gives an important incentive for firms to hire new employees, particularly in high-risk business, in times of crisis and for new start-ups.

The Dutch protection of employees is far-reaching, and may sometimes impose severe restrictions on (foreign) employers, e.g. in connection with the termination of the employment agreement. In Greater Copenhagen, cross-border cooperation with Region Skåne presents both a challenge and a regional strength. Different rules and regulations hinder labour market integration – particularly for workers who are not EU citizens.

Recently, a law has been passed that allows researchers working in the European Spallation Source (ESS) to live and work in both countries.

Flexible labour laws that make it possible for companies to scale up and down are highlighted in both the Danish and Irish case studies as drivers of FDI and start-ups. Supplementary initiatives to improve the accessibility of urban centres from related rural territories can increase mobility and help prevent bottlenecks from arising in the in the labour market. Such initiatives will also reduce regional disparities because benefits spread to other locations in the functional region. In Germany, the NFX – Nurnberg Fürth for Excellence initiative, for example, offers an office free of charge for up to three months to foreign companies that want to start activities in the region. This program started in 2010 and 33 companies have negotiated a grant agreement during the six first years, contributing to the creation of 218 new jobs.

- **Implement and enforce efficient competition policies.** Enforcement of competition policies and equal treatment of foreign and domestic firms will provide a level playing field that reduces the risk for foreign firms when establishing a business in the region. This is important in most types of regions, and competition policies could thus benefit from being enforced efficiently by competition authorities at the national level.

#### 4.4 Regional policies to attract more FDI into European regions

Seven case studies have been carried out to identify good practices in attracting FDI and integrating the attraction of foreign firms in regional and development strategies. The scientific report, *Case studies of best practices in FDI promotion* offers a synthesis of the findings from the seven case studies and a detailed description of some of the initiatives that respondents (e.g. private firms, policy makers and investment promotion agencies) have identified as best practices. In summary, the case studies and quantitative analyses point to a set of initiatives at the regional level that can stimulate FDI inflows:

- **Strengthen existing clusters or build new clusters around existing strengths.** Initiatives to build strong industry clusters can be a way to ensure sustained regional growth, particularly for less advanced regions where the local market is less attractive and in manufacturing (particularly technology-intensive) sectors. Depending on the characteristics of the specific region and industry, such initiatives could involve public R&D, collaboration between universities and private firms, and various education programs.

Strong clusters can also benefit local SMEs and spur entrepreneurship, which will support sustainability and growth in the region. However, to serve as a magnet for foreign investors, a high level of agglomeration maturity is important. Wroclaw Agglomeration Development Agency (WADA), for example, has recently shifted focus from a broad-based approach towards FDI attraction to capitalising more on clusters that have emerged organically up until now. This finding emphasises the place-based approach to FDI promotion that builds on existing industrial and knowledge bases. In Ireland, IDA Ireland

delivers tailored value propositions and marketing messages to different sectors to support the development of industry-based clusters – often with a regional dimension.<sup>46</sup>

- **Secure a competitive skills base.** The existence of a strong skills base in the region is an important prerequisite for benefiting from knowledge spillovers and attracting FDI in the more knowledge-intensive sectors. A high level of tertiary education, for example, is thus a particularly strong driver for FDI into urban, capital and other metropolitan regions as well as more developed regions. Likewise, regions with high levels of innovation attract more FDI in certain knowledge-intensive sectors. While the overall level and quality of education is largely determined at the national level, the case studies show that there is plenty of scope for carrying out active strategies at the regional level to increase the size of the local talent pool. This could be development of apprenticeship programs and other vocational opportunities – even in high skilled sectors (e.g. Dublin and Lombardy); cross-sectoral collaboration on skills matching (e.g. Ireland’s Regional Skills Fora); cross-border labour market integration (e.g. Greater Copenhagen); strategies to attracting high skilled professionals from outside the country (e.g. the Dutch Government’s accelerated application procedure for ‘knowledge migrants’); fiscal incentives for hiring young employees (e.g. Lombardy). The fast-paced evolution of digitisation and technologies implies that ICT skills are crucial and can easily become a bottleneck too.
- **Attract foreign talents.** Regions with a combination of labour abundance and high skill levels attract more FDI, and continued inflows of FDI thus require an abundant pool of qualified labour. Education policies and initiatives to increase labour supply can support this, but many countries and regions also have initiatives to attract foreign talent to add to the pool of qualified labour. Classic factors such as affordable housing, international schools, information and activities available in foreign languages, good accessibility for people and strong industry clusters will also support this. To facilitate labour migration and attract the high-level professionals, for example, the Dutch Government has an accelerated application procedure for highly skilled migrants or ‘knowledge migrants’. As another example, Ireland is the only European country where the US Preclearance Facility is available, which reduces time to undertake US immigration, customs and agriculture inspections. A vibrant and culture rich environment is also an increasingly important draw-card for attracting high-skilled workers. Wroclaw, for example, has benefited from its recognition as the European capital of culture in 2016. In addition, Milan is recognised as a world fashion and design capital– an important factor of attracting foreign talent to the region.
- **Invest in accessibility.** Many non-European investors look to the European Single Market as a whole or to large territories within Europe (e.g. North and South) as the end market. Accessibility in terms of transporting goods will be important for regions that brand themselves as production and transportation hubs into other regions and countries. A developed physical infrastructure for transporting goods is particularly important for manufacturing firms, whereas good accessibility for people is more important for firms in the service sectors. The Nuremberg Region, for example, is well connected within Germany and its neighbouring countries thanks to the rail, road and water infrastructure, including Trans-European networks (TEN-T) and five international airports within 200 km

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<sup>46</sup> This is also one of the key conclusions in the European Commission (2013), *The role of clusters in smart specialisation strategies*. Both cluster policies and Smart Specialisation Strategies are policy approaches with a place-based dimension, aiming at exploiting advantages of proximity to promote economic growth and competitiveness.

from Nuremberg. Investments in physical infrastructure seem to pay off particularly well in less advantaged regions, in particular when such investments ensure access to more developed markets, but also in capital metropolitan regions where congestion can create bottlenecks for continued economic growth. In the capital metropolitan regions, accessibility in terms of the mobility of people (e.g. airline connections) is also important. Although the Dutch market is rather small, its strategic position and good logistics infrastructure (i.e. short lead times) between main markets, such as the UK, Germany and France makes it attractive to foreign investors. Digital accessibility becomes increasingly important, and initiatives to stimulate and increase benefits from digitisation are present in all case studies. The Nordic Region, for example, is well known for its high penetration of digitisation (e.g. health care system, public institutions). In combination with the 19 science parks and innovation incubators and 17 universities and colleges of higher education in the region, the high level of digitisation offers rich opportunities for companies to test new digital solutions in “living labs”.

- **Stimulate internationalisation and targeted regional branding.** Regions that already host a large number of foreign companies are more likely to attract even more FDI, particularly FDI from the same origin. This is particularly important for less advanced regions (i.e. rural, non-metropolitan and less developed regions).

Targeting investment promotion activities to partners where bilateral relations are already established could be an efficient way to use these region’s FDI promotion resources (could be coordinated at the national level in smaller countries). This could be countries with close historical or cultural ties or source countries where there is already a community of nationals in the region (e.g. through initiatives such as Copenhagen Capacity’s ‘Goodwill Ambassador Programme’ and the 28 Bavarian representative offices worldwide). Similarly, Catalonia has 39 offices worldwide dedicated to promote investment in the region.

The Dutch case study highlights the use of ‘diplomatic network’ in the branding of the Netherlands abroad (i.e. embassies, consulates and the like). In addition, international events in key strategic sectors can help strengthen existing clusters. Finally, as English is the main business language in extra-EU FDI transactions, a high level and use of English will stimulate FDI inflows as demonstrated by the Irish case study. The high level of English proficiency in the Nordic countries was cited as a driver in the Greater Copenhagen Region case study. Internationalisation also plays a leading role in many parts of the Dutch society, e.g. in education, which has a strong emphasis on foreign languages. The Hague region is home to many excellent, high standard educational facilities, including a large choice of international schools at both primary and secondary level.

#### **4.5 Regional policies to increase benefits of FDI inflows**

Although traditional objectives of FDI prevail (mainly with a focus on job creation), more emphasis is now placed on the contribution of foreign firms to the overall development and competitiveness of local firms. This contribution is facilitated by collaboration between local and foreign firms and productivity spillovers that boost local firms’ competitiveness. Optimising such benefits from FDI requires that FDI policies are integrated into regional development policy and form an integral part of the wide range of instruments that are being applied in the region to



build competitive advantage (e.g. development of infrastructure, human resources and entrepreneurial networks). Such initiatives could:

- **Integrate foreign firms in the local economy to optimise knowledge spillovers.** In the case of the Nuremberg Metropolitan region, for example, a framework for cooperation between different regional economic actors has been developed to promote innovation and expand regional value chains. To optimise spillovers to other firms within high R&D and technology-intensive sectors, the Wroclaw Agglomeration Development Agency provides ongoing support to firms once they are established, hosting events that bring people from different sectors and different types of businesses together. This enables the introduction of new technologies, products and services and leads to more competition and entrepreneurship.

Similarly, firms in The Hague region get support to take full advantage of each other's knowledge and networks. Invest in Lombardy, as another example, organises round-table discussions with foreign firms to monitor the status of their investments and provides needed support such as assistance with finding a new location or requesting research incentives. In Greater Copenhagen, IBM has a wide range of innovative technologies (e.g. cognitive computing) developed for a specific domain or industry but they sometimes lack the right domain expertise (e.g. health care, transportation etc.). In this case, they partner up with a local company that has the requisite skills. Such interactions between multinationals enterprises and local companies enhance productivity creating spillovers through knowledge and know-how exchange.

- **Offer after-care support to established foreign firms.** Given that new jobs and investments in many cases emerge from expansions of foreign firms already located in the region, after-care is a key ingredient in making a region more competitive in attracting FDI. For instance, approximately 50-65 per cent of annual FDI entering Catalonia is made by companies already established in the region. For this reason, Acciò – Catalonia Trade and Investment – provides support to industries and foreign firms after they have established in the region by regular touch points, offering 'value propositions', assuring integration of clusters and other key players.

Ensuring maximum benefit of FDI for the region and building a strong regional "brand" often means providing on-going contact with firms, even after they are well established in the country. This will stimulate expansions of existing firms and enhance the signalling effect of FDI. Given that the decision to expand and relocate production is not always made by the local management team, after-care can also involve close dialogue with the upper-level management team abroad. Given that M&As account for more than 70 per cent of total FDI inflows into Europe, after-care support can also be relevant for local firms that have been taken over by a foreign multinational company – not only for greenfield establishments.

## 4.6 Inspiration to future analysis and research

This study has answered important questions concerning the drivers and impacts of extra-European towards Europe. At the same time, the study also opens up new questions:

- **What are the impacts of M&As in different territorial contexts?** M&As can have both positive and negative impacts on the regional economies in Europe. M&As accounted for more than 70 per cent of the total FDI inflows towards Europe and it is thus important to

have a good understanding of what happens to European firms after take-over and what policy makers can do to increase the potential benefits and reduce potential losses.

- **How effective are financial investment incentives in attracting FDI?** The current analysis suggests that regions, where the use of financial investment incentives is allowed under the EU rules on state aid, are more likely to host non-European owned firms than regions where this is not allowed. Financial investment incentives can thus help attract FDI to economically lagging regions in Europe and stimulate convergence. However, we do not know to what extent such investment incentives are actually being used, how these incentives work and how effective they are in terms of stimulating FDI that would not otherwise have taken place. Therefore, this area could be examined more closely.
- **Have drivers of FDI changed in recent years?** This analysis examines the location of all non-European owned firms presently located in Europe, and so includes both firms that were established several years ago (and have chosen to stay) and more recent establishments. A changing investment climate due to innovation and smart specialisation strategies in Europe may have changed the investment patterns and drivers over time. A focused analysis of the location decision of more recent establishments (e.g. within the last three years) could cast some light on this. In this context, further analysis of the importance of innovation as a driver of FDI towards Europe would be particularly relevant.
- **How important are regional interdependencies for FDI attractiveness and impacts?** Another field of research could be to analyse spillovers on a more aggregate level (e.g. NUTS2) in order to explore the full reach of these spillovers. It may be the case, for example, that less attractive regions host less FDI themselves but benefit from FDI located in other regions as suppliers or homes for workers in the foreign firms. The results also show that the location of non-European firms in Europe depends partly on regional characteristics measured at both the NUTS3 and NUTS2 level. This implies that NUTS3 regions can become more attractive because of policies enacted at the NUTS2 level.

#### 4.7 Concluding remarks

FDI has the potential to create new jobs directly in foreign firms, increase production and stimulate economic development. This will in most cases increase demand from local suppliers and support sustainable development in the region. Foreign firms also hold technical, operational and managerial knowledge that local firms can tap into and thereby improve their productivity. This explains why European countries, like other nations around the world, make significant efforts to attract foreign companies.

However, a positive net contribution of FDI on the regional economy cannot be taken for granted. Local firms who are in direct competition with the foreign firms may lose market share (crowding out) and adjust their production capacity, which means that jobs in the foreign firm to some extent reflect a replacement of jobs in local firms. If the new foreign firm furthermore uses less domestic suppliers than the local firm that is replaced (replacement), the net impact on job creation may even be negative. The knowledge spillovers may also be limited, e.g. if the local firms have limited interaction with the foreign firm or have low absorption capacity. We find that the presence of foreign firms has on average no impact on the employment of local firms in the region. Any positive and negative impacts (through crowding out, replacement and productivity

enhancements) that foreign firms have on employment among local firms net out on average, which means that the jobs created directly in the foreign company are not merely replacements of jobs in local firms.

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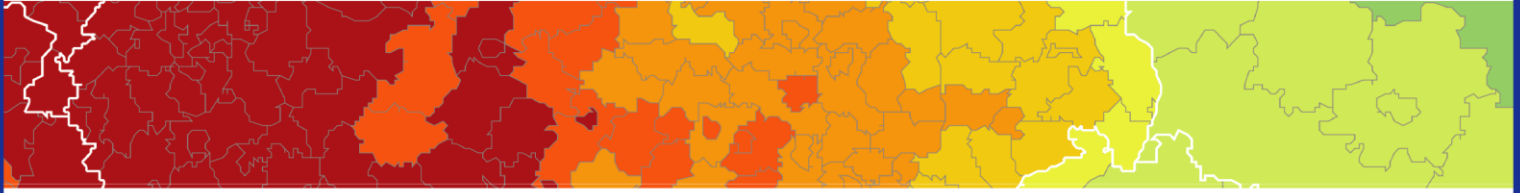
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