Investment in 'Global Britain' – gain, retain … or risk economic pain?

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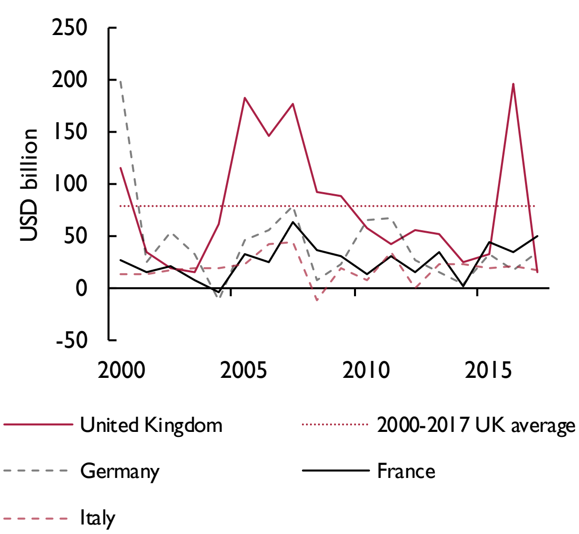
This box reviews recent trends in foreign direct investment (FDI) based on various ways of measurement. It highlights the importance of reinvestments alongside new investment projects and shows that to bolster future welfare, policy should not only focus on publicity-generating new investor arrivals but also create an economic environment that encourages current foreign investors to retain and expand their existing investments in the UK. This is of particular relevance in the context of the government's ambition to advance the UK's position after Brexit as an outward-looking economy.[1]

FDI measures investments made by foreign entities in domestic enterprises and has three components: equity capital, reinvested earnings and intra-company loans. FDI inflow data tends to be very volatile and often reflects large investment projects by individual firms making comparisons over time difficult. Figure 1 shows that in particular prior to the Great Financial Crisis, FDI inflows into the UK were soaring.

To draw comparisons across countries and over time, a better measure is the stock of FDI. In 2017, total inward investment stocks in the UK exceeded US$1.5 trillion according to latest data from the United Nations Conference on Trade and Development (UNCTAD), nearly four times as much as Italy (378 per cent), and nearly twice as much as France and Germany (168 per cent and 179 per cent respectively).[2] The UK is also a large source of foreign direct investment abroad, until 2016 holding more in assets abroad than foreign investors held in the UK. Within Europe, only German firms have accumulated higher FDI stocks.

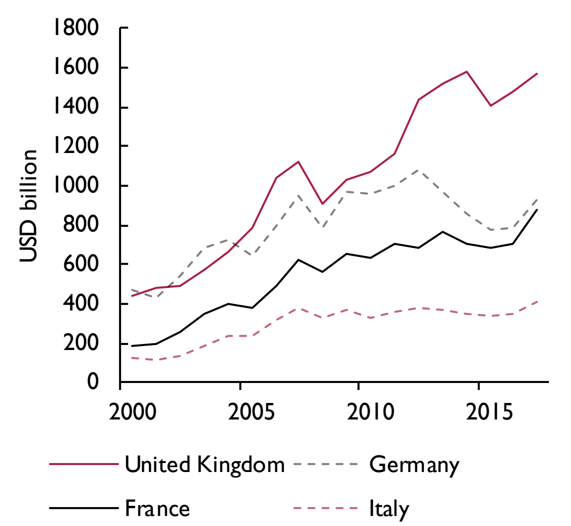
A third measure is counting the number of ongoing investment projects, which often allows for timelier estimates compared to stocks and flows data. Figure 3 shows data from the Department for International Trade on recent trends in the number of investment projects. The figure highlights an important distinction between new investment projects and those aimed at maintaining or expanding existing investments. It shows that, in recent years, reinvestments have made up more than half of all FDI projects, which also include those that result from mergers and acquisitions. This is also reflected in FDI flows and is a widespread feature in developed economies. According to the UNCTAD 2017 *World Investment Report*, "in 2016, as in the previous year, reinvested earnings accounted for roughly half of FDI outflows from developed-country [multi-national enterprises]" (p. 15). In the UK, reinvested earnings accounted for more than half of all inward FDI in 2017 and for 70 per cent in 2018 according to Eurostat.[3] It is therefore a worrying sign that since 2017, not only the number of new investment projects, but also reinvestments have been falling. Anecdotal evidence of international carmakers closing car plants in the UK and relocating elsewhere, as well as research based on

Figure 1. Inward foreign direct investment flows



Source: UNCTAD.

Figure 2. Inward foreign direct investment stocks



Source: UNCTAD.

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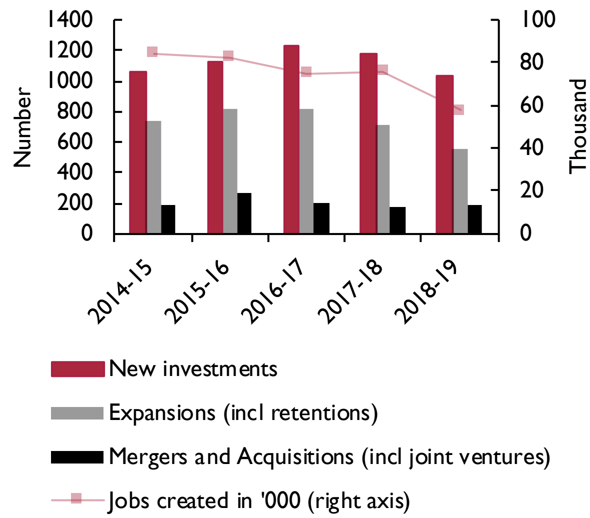
Investment in 'Global Britain' – gain, retain … or risk economic pain? (continued)

most recent investment data (Breinlich *et al*., 2019), suggest that uncertainty about the UK's future trading relationship with the EU takes a large part of the blame. Single market and customs union membership enabled non-EU investors to enjoy the UK's business friendly environment while being able to access the European market without major frictions to trade and global value chains. Uncertainties around global trade and new trade agreements between the EU and third countries, like Japan, which eliminate frictions to trade that otherwise would have encouraged foreign companies to produce locally, are likely to have contributed to a global slowdown in FDI.

Figure 3 also shows that the number of jobs created by foreign investors has dropped by 23 per cent since 2016. Often FDI is associated with better ideas and management practices competing with those of local incumbents (so-called 'demonstration effects', see Görg and Greenaway, 2004; Helpman *et al*., 2004).[4] If the slowdown of FDI were to continue in the future, this would pose an important risk for employment and productivity in the UK. Investment data suggests that the focus should as much be on retaining current investors as on attracting new ones from around the globe.

Figure 3. UK inward foreign direct investment projects by investment type (number of projects)



NOTES

1 Members of government have been using the label 'Global Britain' to promote trade openness, international political cooperation and importantly also international investment after Brexit. An overview of the use of this label by the government and a critical review is provided in House of Commons Foreign Affairs Committee (2018), *Global Britain. Sixth Report of Session 2017–19*.

2 While UNCTAD is reporting FDI stocks data in historical cost terms to address revaluation effects, differences may still arise between FDI flows and first differences of FDI stocks as the result of different underlying data sources and definitional discrepancies.

3 Balance of payments statistics.

4 For a detailed discussion of short- and long-run economic effects of FDI see also Chadha (2016).

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