With Brexit, inward investment will fall in the UK

Both in the run up to the referendum, and since the UK voted to leave the EU, there has been a good deal of speculation over the likely impact on inward FDI into the UK. In a timely recent piece for Columbia FDI Perspective, Laza Kekic suggested that UK inward investment will remain robust post Brexit. We beg to differ.

Japanese inward investors, backed by the Japanese government, have been keen to stress that future investment in the UK depends on tariff-free and barrier-free trade with the EU that is as uncomplicated and predictable as possible. A Japanese government memorandum has expressed concerns over the continued viability of Japanese investment in the UK in the event of a hard Brexit without access to the Single Market. Nissan has also commented that it will review its decision to build the next generation of the Qashqai model in the UK when the form of Brexit is clearer. Meanwhile, Toyota’s recent investment announcement only follows through on a decision to build the next generation Auris and Avensis that was made well before the Brexit vote last year. Those that are household names (such as Nissan and Toyota) are lobbying hard to cut special deals with the government.

When the Single Market was created, many commentators speculated that intra-EU FDI would plummet. This turned out to be far from the case, as firms took advantage of the opportunities to coordinate resources across countries, and location advantage dominated issues relating, for example, to economies of scale. The Single Market, through EU regional policy and structural funds, allowed firms to take full advantage of location economies where labor was available in low-cost locations. Supply chains cross borders several times before components go into, say, a final assembled car, which could happen in several EU countries. Equally, as firms redesign their production systems to a more compartmentalized network system, free movement of labor also becomes important, allowing firms to move labour quickly and cheaply to respond to short terms changes, or to address skill shortages. The UK has chosen to cut itself off from much of this.

Finally, we have already seen a big devaluation in sterling. On the one hand, this makes domestic assets cheaper for foreign investors, and there have been some investment into the UK on the back of this. On the other hand, devaluation lowers the expected returns from UK investment when translated into the home country’s currency. An analysis of 50 years of time-series data for UK inward investment suggests that in (typically brief) periods of uncertainty, a depreciated sterling offers a temporary, albeit positive, effect on FDI. But when the economy returns to being stable once again (the much more common state, at least, over the past half century), the effect is not only annulled, but becomes both reversed and persistent. In other words, a weaker currency will eventually lead concerns over lower future returns to dominate strategic thinking. This, in turn, will inevitably drive investment elsewhere.
Nevertheless, there are some big projects that will take place in the UK irrespective of Brexit—the HS2 train line or Hinckley Point Power Station are examples. Foreign investors will be attracted by such activity. Still, they are not bringing new business as such activity is proceeding independent of Brexit.

More realistically, locations need to consider the nature of their value proposition to inward investors, backed up by land availability, which possibly involves some difficult decisions regarding opening greenbelt land. Part of this proposition needs to involve building more robust supply chains to support inward investors; addressing skill shortages in overheated labor markets; and working with firms and universities such that they become anchors for both foreign and domestic investment. Some of these will require a more activist industrial policy in terms of, say, rebuilding supply chains in the UK and encouraging “reshoring.” It is possible that UK regions may be able to be more proactive in attracting inward investment—although one hopes that this does not herald a return to the excessive subsidies that were paid in the 1990s.

Above all, however, the government needs to avoid a hard Brexit that sees tariff barriers returning, and, ideally, to execute a trade deal that prioritizes access to the Single Market for as many sectors as soon as possible. It is possible that digital tracking of goods may offset many of the concerns expressed pre 1992 regarding goods awaiting physical customs clearance between the UK and EU, that may in turn protect some supply chains. The importance of such costs and delays must not be underestimated. This however is potentially incompatible with the desire of the UK to prevent free movement of labour between the UK and EU, which may in itself deter FDI.

Also on Brexit:

[Link to blog post]

Brexit: blame it on the loss of industrial jobs, not on globalisation

Notes:

- This blog post was originally published at Columbia FDI Perspectives.
- The post gives the views of its authors, not the position of LSE Business Review or the London School of Economics.
- Featured image credit: Final assembly, by Brian Snelson, under a CC-BY-2.0 licence
- Before commenting, please read our Comment Policy.

David Bailey is a professor in the Economics, Finance & Entrepreneurship Department at Aston Business School. He is an influential business expert on economic restructuring and industrial policy is perhaps best known for his knowledge of UK and West Midlands car manufacturing. As an author, regular media commentator and newspaper columnist, he has provided articles and commentary on key economic and regional policy issues including the closure and eventual reopening of the MG Rover car plant in Birmingham, UK, and the Jaguar Land Rover economic success story. Most recently, David has undertaken European-funded research on using foreign investment to upgrade clusters and on industrial and regional policy and the rise of ‘phoenix’ industries such as the low carbon vehicles cluster in the West Midlands.

Nigel Driffield is a Professor of International Business at Warwick Business School, having held a similar post at Aston Business School for 10 years. He is also Deputy Pro Vice Chancellor for Regional Engagement. As well as pursuing academic research, he also works with a number of stakeholders, both locally and nationally on issues relating to inward investment and economic development. I was on the Executive for the (Heseltine) Greater Birmingham Project with the Greater Birmingham and Solihull Local Enterprise Partnership, and held a similar role in the production of the Strategic Economic Plan. He is on the editorial review board of the Journal of International Business Studies, and was a member of the Management and Business Panel for REF2014. More generally, he has held 5 ESRC awards, and has carried out research and consultancy projects for UNCTAD, OECD, World Bank, European Commission, and in the UK several Government Departments including UKTI and BIS, and several local Regional Development bodies in the UK and elsewhere.

Date originally posted: 2017-07-19
Permalink: http://blogs.lse.ac.uk/businessreview/2017/07/19/with-brexit-inward-investment-will-fall-in-the-uk/
Blog homepage: http://blogs.lse.ac.uk/businessreview/
Michail Karoglou is a lecturer in Economics at Aston Business School. Prior to his current position, he was a lecturer in Banking and Finance at Newcastle University, and a lecturer in Economics at the University of Bath. His research interests are: financial econometrics, volatility dynamics, macroeconomic modelling; time series analysis and forecasting; and the econometrics of structural change.