



The UK's Foreign Investment Post-Brexit and Covid

Briefing 4
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The Productivity Institute

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Highlights

This briefing explores how adopting a more strategic approach to attracting inward investment could enhance its role in improving regional equality, with an emphasis on productivity as the main driver of prosperity.

Analysis of the regional data demonstrates significant differences in the nature of Foreign Direct Investment (FDI) between and within regions. Lagging locations attract a higher proportion of low productivity FDI, while high performing places attract more innovation-intensive, high-productivity FDI.

Regional inequalities are worsened by the differences in the ability to attract high productivity investment. Achieving the goals of levelling up will therefore require policies targeted at attracting inward investment to lagging regions.

Introduction

We recently developed a think piece on inward investment attraction and levelling up for The Department for Business and Trade and the Office for Investment. This project was prompted, in part, by the [National Audit Office Report](#) on UK's inward investment promotion, the insights from the [Harrington Review](#) into inward investment, and TPI's collaboration with the [CBI](#) on addressing the challenges of attracting re-investment from existing foreign-owned enterprises into the UK.

Tackling inequality of productivity and improving employment opportunities will remain a priority for any new UK government. The differences in productivity - and therefore earnings - across [UK regions](#) are startling. For the past three decades, inward investment policy in the UK has been closely intertwined with industrial and regional policies, serving both to attract FDI to help position the UK at the frontier of certain technologies and as a tool to address long term unemployment in areas still suffering from industrial decline.

The trade-off - The challenge for levelling up

Locations face a trade off when seeking to attract FDI: whether to prioritise FDI that will deliver new jobs (or protect existing ones) or deliver an improvement in the rate of innovation. This choice is by no means a trivial one for any local or national level government, as it includes considerations around protecting existing employment and managing the trade-off between immediate job creation and fostering long-term innovation.

Often a dichotomy tends to emerge between:

1. FDI that generates a lot of employment typically in relatively low value activities;
2. FDI that introduces new technology, and employs individuals in high-tech activities with high wages, but in relatively small numbers.

The dilemma best evidenced by the challenges faced by Local Enterprise Partnerships. The challenge for policy makers is to ensure that the latter type of FDI becomes embedded in the local economy, making as much use of local supply chains as possible and utilising business support to facilitate firms in pivoting towards new opportunities.

A two-speed economy?

The UK is made up of two main types of local economies with different equilibria. The first are locations with high levels of innovation, skills and therefore strong productivity performance. Such places exist not only in London and the South East, but also in other localities throughout the country with high value assets, including infrastructure, human and financial capital. Those locations are best placed to attract more high-tech FDI, as well as venture capital, to support local ecosystems. As discussed below, these characteristics directly map onto a relatively strong earnings potential, with obvious examples including the areas around Oxford and Cambridge.

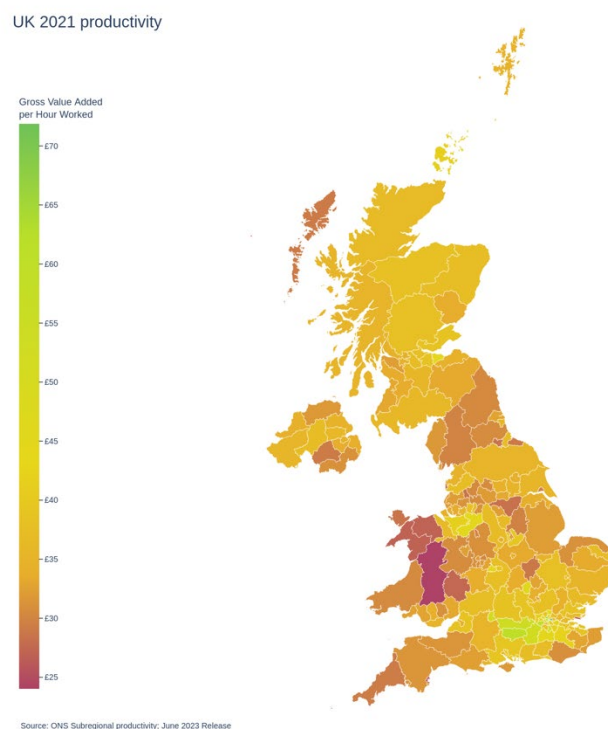
The second group of locations are ones that can be characterised as “low skill equilibria” locations, which do not necessarily exhibit high levels of inactivity, but struggle with relatively low levels of innovation, skills, and productivity. As such, inward investment, while generating employment and being higher value added compared to many local firms, is attracted to such places due to available resources, typically less skilled labour, and lower costs in terms of rent, etc.

Spatial differences in productivity

Given the differences in regional productivity across the UK, it is important for levelling up policies to also consider inequality within regions.

Figure 1 presents the regional variation in ITL3 productivity levels relative to the national UK measured as gross value added (GVA) per hour worked¹.

Figure 1. GVA per hour worked by the ITL3 UK regions in 2021



Notes: The reference productivity for the UK is the weighted average productivity of all the ITL3 regions included in the map. Aggregations are based on TPI calculations.

In addition to productivity differences, there are also stark differences in earnings over relatively short distances. The Productivity Institute's report on the [Midlands' productivity challenge](#) highlights disparities like this, including up to 20% differences in average earnings between districts less than 20 miles apart. This suggests inefficiencies in labour markets which places more onus on inward investment policy aimed at attracting investment to lagging

¹ For extensive regional comparisons, see data from The Productivity Lab: <https://www.productivity.ac.uk/the-productivity-lab/overview-regional-databases/>.

regions. These spatial disparities – and their implication for inward investment – have been discussed in detail in previous [briefings](#) on the trends in FDI².

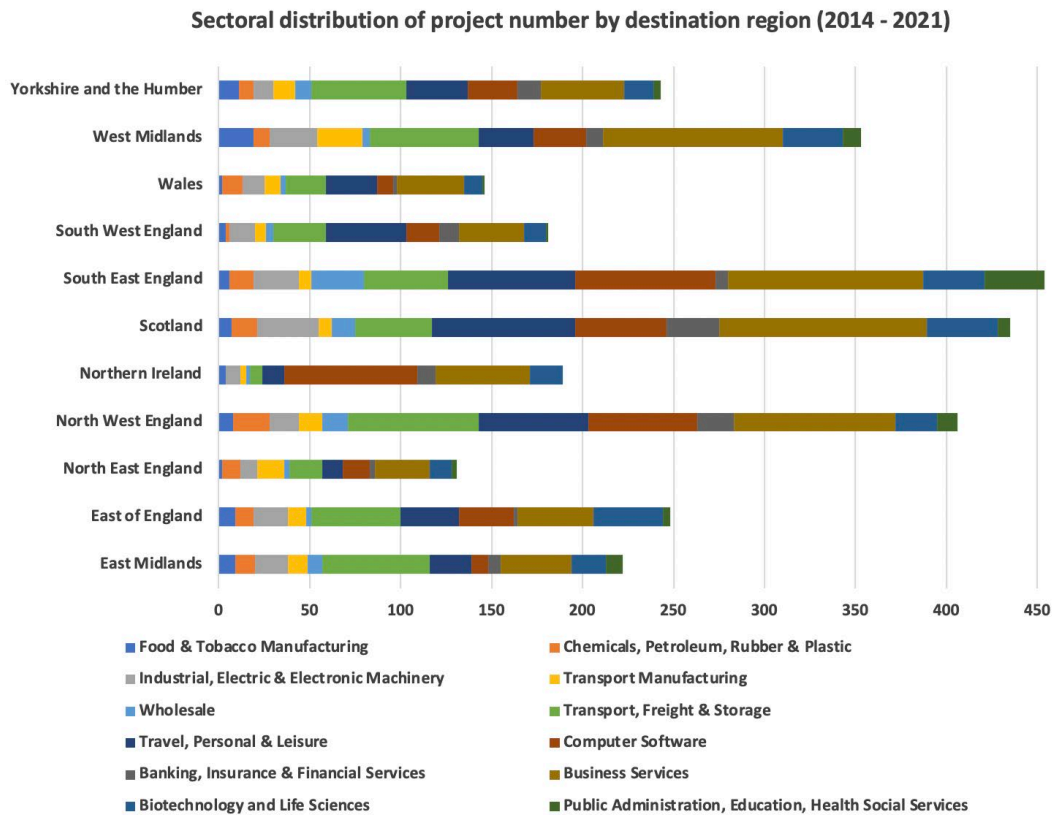
The latest analysis of the [Moody's Cross Border Investment data](#) indicates significant differences in the volume of FDI as well as in the nature of FDI between regions, indicating a strong path dependency. Lagging regions tend to attract more low productivity FDI, while high performing regions attract more innovation-intensive, high-productivity FDI. To truly achieve levelling up beyond mere rhetoric, policies targeted at attracting inward investment need to break this cycle.

To further illustrate the point, the distribution of the number of FDI projects for each ITL1 region data [based on the primary code of sector classification provided by Bureau van Dijk (BvD)] is displayed in Figure 2, focusing on the sectors with the highest volumes of inward greenfield investments. Overall, business services draw the majority of greenfield FDI, followed by computer software, travel, personal and leisure, and transport, freight and storage. However, these sectors also represent both the highest productivity sectors, such as business services and software, and the lowest, like transport freight and storage, in terms of inward investment in the UK.

Similarly, the fastest-growing industries with relatively high productivity, such as biotechnology and life sciences, computer software, and business services, are unequally spread at the subnational level. Undoubtedly, Greater London emerges as the most attractive destination for FDI projects related to business services, achieving a much greater reach than Scotland, South East England, and West Midlands, whereas computer software sector primarily contributes to investments in Greater London, South East England, and Northern Ireland.

² This has been discussed in detail in our earlier briefings, which can all be found by visiting <https://www.productivity.ac.uk/research/the-uks-foreign-investment-position-post-brexit-and-covid-briefing-3/>

Figure 2. Number of projects of the top 12 BvD sectors by ITL1 destination region, 2014-2021



Source: Orbis Crossborder Investment database and authors' own calculation

Note: South East England does not include Greater London, which is excluded for better focus on the rest of the regions.

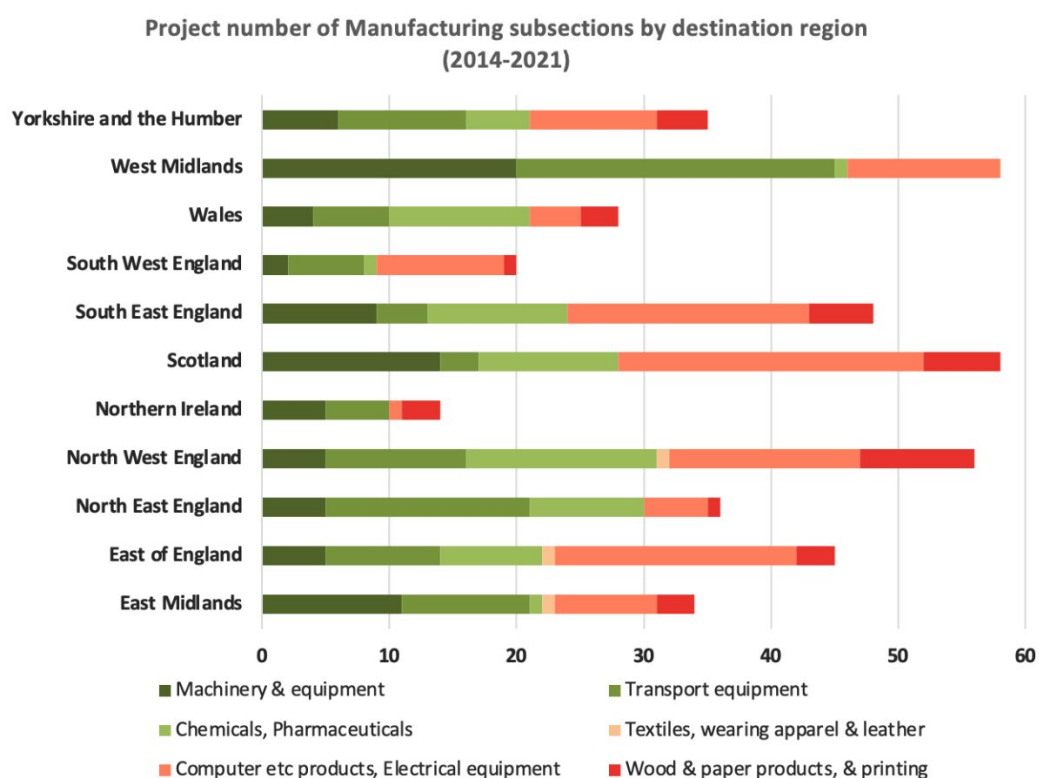
Inward investment, productivity and levelling up

To look more closely at the locations of both the most productive and least productive FDI. The top three sectors in terms of productivity—machinery & equipment, transport equipment, and chemicals & pharmaceuticals—are highlighted in green, while the bottom three—textiles, wearing apparel & leather, computer products & electrical equipment, and wood & paper—are marked in red in the below Figure 3.

We then map the number of greenfield projects in selected sectors across the UK ITL1 regions, based on the average of indices for each sector between 2011 and 2020. The rationale for conducting this level of analysis is as follows. While productivity may vary within sectors across different locations, it remains true that there are, regardless of location, distinct “high

productivity” sectors and “low productivity” sectors³. In simplified terms, high productivity FDI is associated with higher levels of knowledge intensity, necessitating higher levels of capital and skills, whereas low productivity is associated with greater reliance on labour input. From an economic development perspective, both aspects may be important, with the latter being associated with employment creation on a larger scale. However, only the former has the potential to move the dial on regional productivity.

Figure 3. Number of projects in the 3 most productive and the 3 least productive Manufacturing Industries by ITL1 region, 2014-2021



Source: Orbis Crossborder Investment database and authors’ own calculation

One can observe immediately from the above figure that high concentrations of high productivity FDI align closely with pre-existing strengths. For instance, machinery and equipment, transport equipment, and chemicals and pharmaceuticals rank as the top three productive sectors. Regions such as the West Midlands, North West England, North East England, and Scotland outperform others in attracting greenfield projects targeting these top

³ See for example: <https://www.productivity.ac.uk/wp-content/uploads/2021/11/WP013-Organisational-Capital-scoping-paper-FINAL-151121.pdf>

productive sectors. In contrast, textiles, and wood and paper represent the lowest productivity sectors, with FDI concentrated in Scotland and the North of England.

Perhaps the most intriguing sector for our analysis is the computer products and electrical equipment sector, which exhibits low productivity on average in the UK and is characterised by high concentrations of assembly operations in low-wage areas alongside pockets of high-tech activity in the South East and East of England. In many ways, this encapsulates the challenge of levelling up, and illustrates the difficulties faced by policy makers in breaking this cycle.

As outlined in the traditional International Business literature, one could argue that, typically at the most basic level, inward investment strategy in the UK is concerned with attracting firms with more proprietary knowledge arising from technology, marketing, brand name, capital, access to financing, process efficiencies, size (economy of scale and scope), and managerial expertise.⁴ Such assets in turn will not only generate higher productivity but also yield higher intensities of productivity spillovers. This then turns on the importance of understanding the region's value proposition for those investments, that is, whether such investments represent simply "more of the same" for the region, or are a game changer (or transformative force). Achieving such a better understanding of how inward investment attraction can "move the dial" on productivity requires a more nuanced, targeted activity based (or even firm-level) approach in order to maximise the potential for inward investment to be transformative in catalysing productivity and earnings within a location.

[An illustration of the nature of the problem](#)

For illustration, we provide four 'bubble diagrams' depicting the main FDI sectors across four combined authorities. The purpose of these figures is to visually illustrate the interplay between jobs growth and productivity growth, and the relationship between these two dimensions and FDI. Specifically, we investigate the relationship at a local level between the growth in value added within a sector and the growth in employment across four 4 selected MCAs. Sectors that provide jobs growth may be welcome in terms of job opportunities. If those sectors represent "more of the same" or do not provide additional GVA growth, then the growth of these sectors is unlikely to be transformative. Conversely, if sectors generate

⁴ Typically, the FDI literature groups these concepts together and refers to them as "Firm Specific Assets"

value added growth without employment growth, the secondary benefits to the region are likely to be limited.

The four figures presented below illustrate the relationship between the growth of employment (x-axis) and growth of gross value added (GVA) (y-axis) across various sectors, with bubble size denoting the number of jobs created by the investment in a given sector. This presentation helps identify the main FDI sectors for the selected Local Enterprise Partnerships (LEPs), gauging their significance to the regional economy and providing insights into their relative performance.

Overall, these graphs offer insights into the relative importance of key sectors across different regions. For instance, accommodation and food service activities, along with professional, scientific, and technical activities, tend to be more important in the Tees Valley. Figure 4 shows that the sectors attracting FDI in the Tees Valley appear to be more reliant on unskilled labour, compared to the information and communication that attract inward investment in West Yorkshire (Figure 6) and North of Tyne (Figure 7).

Clearly this highlights the importance of accommodation and food service activities for the Liverpool City Region in Figure 5, while also, for example, indicating that inward investment in electricity, gas, steam, and air conditioning supply, as well as transportation and storage sectors, may contribute less to productivity, despite of course providing employment opportunities for less skilled workers. Indeed, this neatly illustrates a key finding from the academic literature: with only a few exceptions, inward investment generally either contributes to productivity or generates significant employment opportunities.

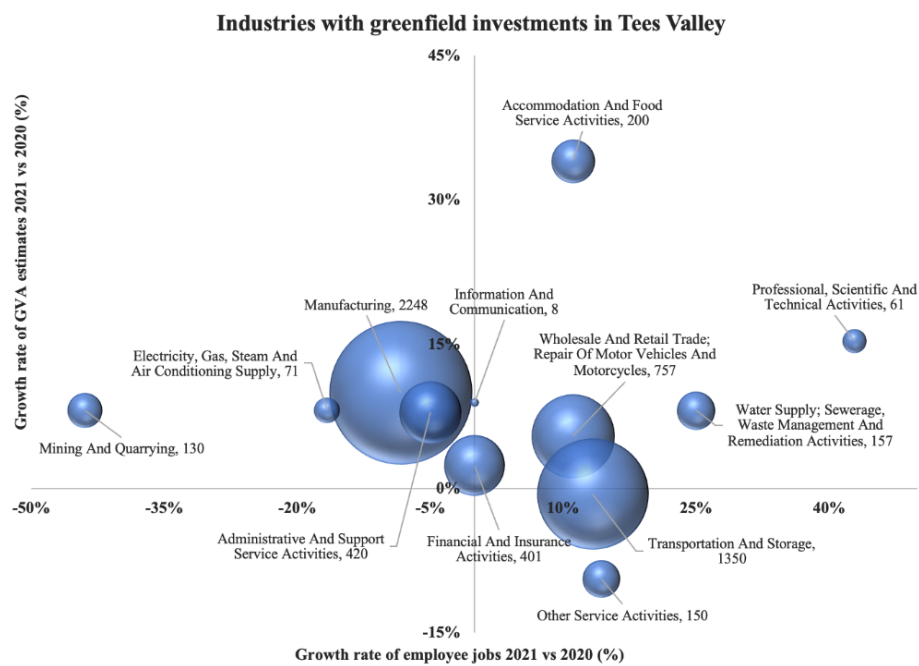
The accommodation and food service activities in the Liverpool City Region demonstrate a dual impact, as do financial and insurance activities to some extent, whereas most other sectors predominantly fall into one category or the other. The Liverpool City Region however presents some other intriguing cases, such as professional services and the provision of electricity and gas, which have demonstrated a (albeit) modest increase in value added alongside a reduction in employment. This would suggest a shift towards greater capital intensity and productivity in these sectors, highlighting the trade-off faced by locations where such investments are required to transform a region's productivity and are needed for long-term regional productivity enhancement, yet local policy makers may encounter pressure to

protect jobs. The challenge therefore lies in leveraging the increases in productivity and fostering supply chains for these sectors to ensure wider distribution of benefits.

Collectively, the figures below underscore the scale of the issue, revealing that many sectors where regions have been successful in attracting FDI exhibit similar growth rates in employment and value added. This pattern suggests that the FDI obtained by these regions primarily yields “more of the same”, indicating a lack of improvement in average productivity within these locations.

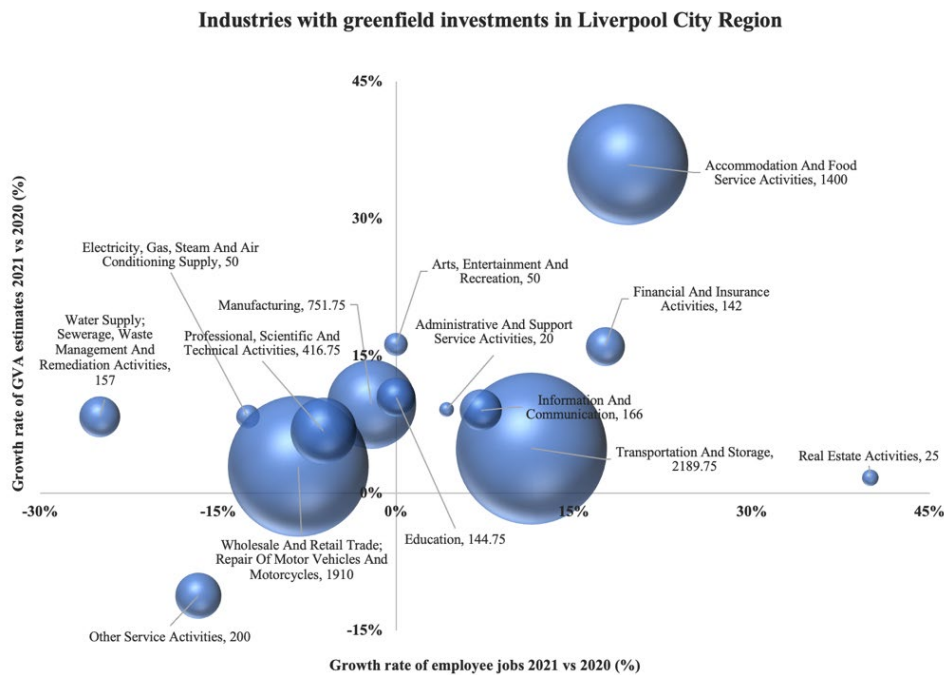
In terms of policy recommendation, policy should focus on enhancing each location and region’s capacity to attract investments, while also strengthening their capacity to establish linkages between FDI and the local economy.

Figure 4. Inward investment across the main sectors in Tees Valley



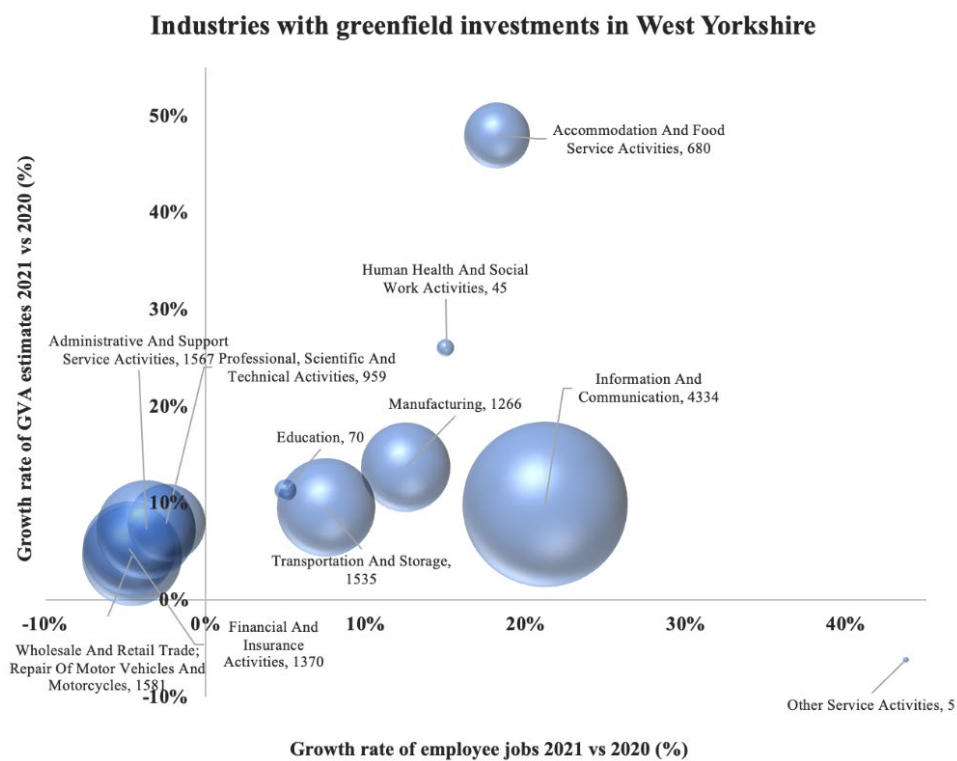
Source: Orbis Crossborder Investment database and authors’ own calculation

Figure 5. Inward investment across the main sectors in Liverpool City Region



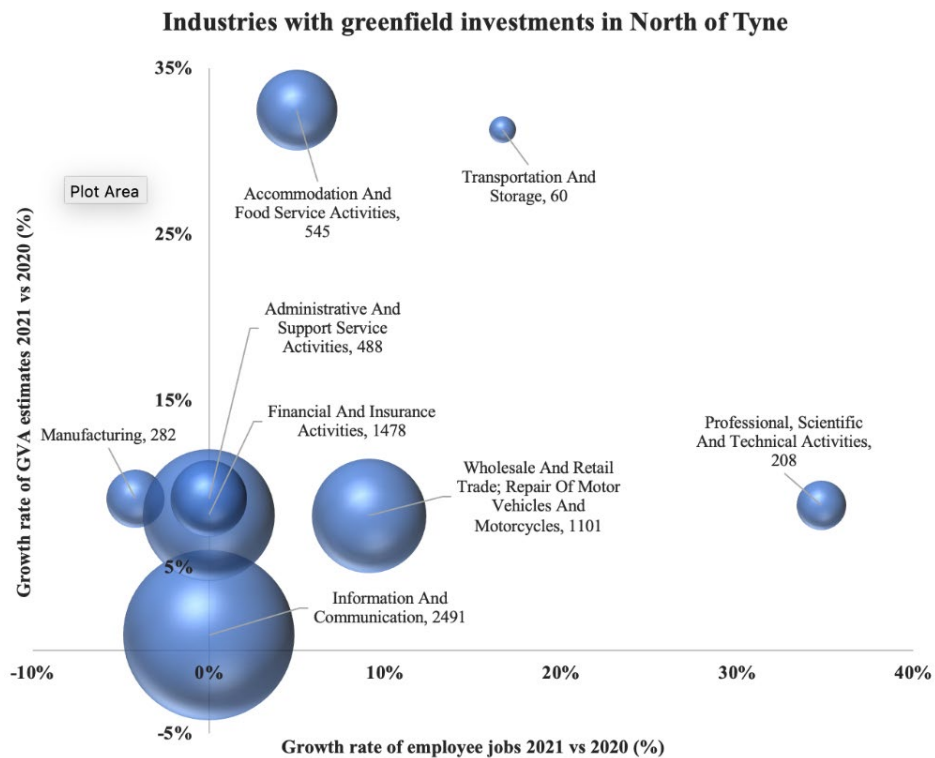
Source: Orbis Crossborder Investment database and authors' own calculation

Figure 6. Inward investment across the main sectors in West Yorkshire



Source: Orbis Crossborder Investment database and authors' own calculation

Figure 7. Inward investment across the main sectors in North of Tyne



Source: Orbis Crossborder Investment database and authors' own calculation

Future research

Our earlier briefings focused on the changing motivations for firms to invest in the UK post-Brexit, along with the changing dynamics of global value chains post-Covid. This briefing, along with the [accompanying paper](#), highlights the challenges that these shifts pose to policy makers. The challenges posed have been highlighted by both the [National Audit Office Report](#) on inward investment promotion in the UK and the [Harrington Review](#) as well as a collaboration between TPI's Midlands Productivity Forum and the [CBI](#). Here we have sought to explore some potential solutions, by considering how a wider set of policy levers can contribute to boosting regional productivity. Through inward investment. As a next step we will extend our analysis by developing a policy framework that links dynamic capabilities at the regional level with those of firms. This aims to establish a framework to maximise FDI benefits at the local level, through targeted policy and associated interventions, such as localised skill provision. We will also examine the importance of evolving geopolitics in understanding the outside options of regions in FDI attraction, considering the trade-off

between employment opportunities and the risks, such as technological appropriation by foreign firms.

Collectively our four briefings have explored: The changing nature of inward investment into the UK, in terms of home country, motive and type of project, and what this means for UK productivity. In turn we then explore potential policy responses, highlighting the level of granularity required to develop a strategy for attracting inward investment that may not only generate employment, but also contribute to regional productivity and the reduction in inequality. As we detail however, this is no simple task.