Does foreign investment drive reindustrialisation in the United Kingdom?

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Summary

For decades, the United Kingdom has made attracting foreign companies a key aspect of its industrial policy. The country's public authorities were convinced from an early stage that the penetration of foreign capital would have a positive impact on the national economy. The British economy demonstrates, in this respect, that it is possible to support national industry without trying to preserve domestic "champions" at all costs. However, it would be naïve to imagine that this international openness is sufficient on its own to guarantee a dynamic, resilient industry. Foreign direct investment (FDI) is only one of the ingredients required for reindustrialisation. If its effects are to be long lasting, the policy that promotes FDI needs to be accompanied by measures for local economic development (infrastructures, support for companies, skills renewal, etc.).

Moreover, the revival of the automotive industry and the modest recovery of industrial employment in the United Kingdom should not detract from, for example, greater poverty among workers and increasing regional disparities. The overall picture is therefore mixed. While the United Kingdom has shown a high capacity to bounce back in the past, its future is highly dependent on the outcome of negotiations regarding its exit from the European Union (EU).

Rapid deindustrialisation that seems to be in check since 2011

Many observers consider that the United Kingdom is no longer a great industrial nation, but rather a country that has "opted for services" and especially financial services[1]. Numerous British industrial champions have either disappeared or been bought out by foreign competitors. The decline was swift: according to Eurostat, in 1970, the manufacturing sector contributed 25 % of national wealth, but by 2015 it only represented 8.7%. In France during the same period, this share went from 20 % to 10 %[2]. Similarly, the share of British manufacturing jobs has almost halved, dropping from 15.5% in 1995 to 8 % in 2015, compared with 14.8 % to 9.7 % in France during the same period.

Nevertheless, the United Kingdom is not only a service-based economy. The country has succeeded in maintaining numerous advantages in sectors like pharmaceutics, automobiles and aeronautics. In addition, since 2011, the British industry has seen its economy pick up, with 23,000 manufacturing jobs created from 2011 to 2016, bringing the hope of industrial recovery. While this figure is modest compared to previous job destructions, it cuts a contrast with French underperformance (112,000 jobs destroyed over the same period).

Using foreign direct investment to develop industrial territories

Unlike its neighbours, the United Kingdom opened up to foreign direct investment (FDI) at a very early stage, since British leaders were convinced that it would have a positive impact on the economy. The country's attractiveness to foreign investors stemmed from its trading tradition, language, and historic commercial ties with the United States. The liberalisation and massive deregulation policies implemented in the 1980s by the Thatcher government increased this attractiveness, in parallel with a policy to encourage the development of services that boosted prosperity mostly in London. Regional and local authorities attracted FDI with incentives, sometimes on the condition of creating jobs in the regions where companies set up. Thus in 1980, FDI inflows into the United Kingdom represented 11.2% of GDP compared to 4.5% in France.

The outcome: according to the United Nations Conference on Trade and Development (UNCTAD), the total FDI stock entering the United Kingdom is 1.7 times higher than that observed in France (700

[1] President Sarkozy, in his televised speech on 5 February 2009, clashed with the British government when he claimed: "Great Britain has no more industry, unlike France. Because twenty-five years ago, England opted for services, and especially financial services".

[2] The United Kingdom still ranks behind France if the energy sector and extractive industries are included in industry. When applying this extended definition, the industrial sector represented 11.8% of British GDP in 2015 and 12.6% in France.

billion USD in 2016). According to the consulting firm EY, taking all sectors together, the United Kingdom is the choice target for investors in Europe, and ranks second in Europe for hosting industrial projects.

FDI has contributed to economic development in British regions and limited the decline of some long-standing industrial territories. The West Midlands, for example, which is the region most affected by deindustrialisation in the UK, has benefited from the establishment of the Indian firm Tata. In 2008, the group bought the brands Jaguar and Land Rover and invested considerable sums to upgrade production systems in its three factories. Its factory in Solihull received over 1.5 billion GBP of investments. The West Midlands saw the industrial share of its GDP increase by 2.5 points from 2009 to 2015, and its unemployment rate drop from 9.7 % to 5.7 % from 2009 to 2016.

Major ideological turning point: the return of industrial policy

The financial crisis of 2008 triggered a major change in direction for public policies. Without explicitly mentioning industrial policy, as soon as it arrived in power the Cameron government expressed a desire to "rebalance the economy, ensuring that success and prosperity are spread more evenly across regions and industries"[3]. Along with a drastic austerity policy, it implemented targeted action on eleven strategic industries[4] and launched a plan of horizontal measures (more flexible labour market, reduced taxes and regulations, etc.). With the arrival of Theresa May, industrial policy is no longer taboo. An economic and industrial strategy has been defined aiming, in the context of Brexit, to "a proper industrial strategy to get the whole economy firing " and not just the service sector. Measures have therefore been taken to, on the one hand, help the most promising industries by targeting technological innovation, and on the other hand, make former afflicted regions internationally competitive again through land management planning (infrastructures, regional growth funds, etc.). These policies break with a long tradition of laisser-faire and limited state role in the economy. It marks a real ideological turnaround for a country that has not had any industrial policy to speak of since the 1960s.

Mixed results, uncertain prospects

Without doubt, the subsidies provided by the state and public bodies initially proved useful to attract investors to afflicted industrial regions and slow down the divide between London and the rest of the country. Nevertheless, these investments, however high, clearly remain insufficient to reverse the decline of local economies. Worse, foreign companies logically tend to choose the regions with the

[3] Department for Business, Innovation & Skills (2010).
[4] Aerospace, agriculture technologies, automotive, construction, information economy, international education, life sciences, nuclear, offshore wind, oil and gas, professional and business services.

best skills and the most dynamic ecosystems. This naturally fosters spatial inequalities within eligible areas. Sometimes, a single “mega-project” locally wins most of the grants because of the expectations it creates. As a result, the advantages of FDI are not fairly divided within territories or sectors. The recovery of industry in the West Midlands for example hides significant disparities in the region. Birmingham, the region’s biggest city, has an unemployment rate of almost 11% and it is clear that attracting foreign investors is not enough to reabsorb years of deindustrialisation and lack of commitment from public authorities. Similarly, although the creation of a Nissan factory in 1986 in Sunderland, northeast England, today contributes to the overall dynamism of the car industry, it also accentuates the polarisation of companies in the area, and consequently of public support, i.e. funding of infrastructure, clusters, etc. For example, between 2000 and 2015[5], manufacturing GDP in the borough of Sunderland rose by 31.4% compared to +13.4% for the whole northeast region (+17.4% nationally).

The arrival of foreign companies has led to job creations, largely facilitated by the increased flexibility of the British labour market. The country’s recovery strategy, based on labour market reforms (“zero-hours” contracts, drop in real wages, etc.), has increased the number of low-qualified jobs. In the West Midlands, the presence of foreign companies has undeniably led to the creation of dynamic ecosystems, and the region has succeeded in maintaining qualified industrial jobs in some domains requiring expert knowledge. However, since the job market started to pick up in 2011, 28 % of jobs created in the region have been insecure, i.e. self-employed jobs on low pay, “zero-hours” contracts, etc. Workers in the West Midlands earned about 900 GBP less in 2016 than they did in 2008[6].

This recovery of manufacturing employment since 2011 is therefore independent from the successful upmarket move achieved by some sectors, such as the automotive industry. Taking all sectors together, the United Kingdom still bears the scars of years of deindustrialisation. The lack of qualifications and skills remains a major challenge. In addition, the number of national companies included in the supply chains of foreign firms remains too low, and the government has only recently made this a condition for its financial support.

Brexit also raises a number of concerns: on the one hand, the United Kingdom risks depriving itself from foreign talents indispensible to the country, given that the most qualified young British people tend to opt for careers in finance. As a reminder, according to Coface[7], the more restrictive immigration policy promised by the government is likely to result in labour shortages: in British

[5] Source Eurostat – Latest data available.
[6] See the production of the Think Tank IPPR North, the Centre for Progressive Capitalism and the Resolution Foundation
[7] Coface, 2017, “Face au Brexit les entreprises britanniques vont-elles filer à l’anglaise?” June.

industry, 10.2% of employees are EU citizens, and a third of these occupy qualified positions. Moreover, access to the common market remains a decisive factor for investors deciding whether to move into a country. The London School of Economics' Centre for Economic Performance[8] estimates that the United Kingdom could lose 22% of its FDI inflows during the next decade.

What emerges from the British strategy on industrial policy and FDI?

Given the country's non-interventionist tradition, British industrial policy has not taken the form of an emergency plan for industry, which would have supported companies in their investment projects, similar to what has been observed in most continental European countries.

Instead, it has implemented horizontal measures – i.e. reduced corporate taxes and regulations, access to SME funding, development of qualified, flexible labour, attribution of public markets to SMEs, and the development of supply chains – and support for several sectors in which the country had major advantages, but this policy is still moderate in scope. The state takes a pragmatic, opportunistic approach to financially contributing to different initiatives implemented locally by private stakeholders, provided that they are beneficial to the economy. As an example, in the automotive sector, the state encourages, accompanies and contributes to investments by emblematic foreign companies such as Nissan and Jaguar Land Rover (now owned by Tata) to develop their local activity and the ecosystem (R&D centres, clusters). The public authorities consider that the closer the ties a foreign company makes with its territory, the more expensive it will be for it to relocate its activities in the future.

Local authorities, to which the state transferred budgets and skills in 2010, have made considerable efforts. They seem to take a pragmatic approach determined by their understanding of companies' needs and, unlike French competitiveness clusters for example, do not impose that all sectors and territories that receive aid must meet the same eligibility criteria defined by the state.

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The mobilisation of public authorities remains crucial to make best use of the benefits resulting from foreign companies' location in the United Kingdom. It is not enough to attract FDI by promoting the country's assets; it needs to be simultaneously accompanied by a policy of economic development and planning in order to foster long-term knock-on effects. The key issue for both local and national public authorities is to ensure that the resources (natural, fiscal, land and human) that they devote to

[8] Dhingra S., Ottaviano G., Sampson T., Van Reenen J., 2016, "The impact of Brexit on foreign investment in the UK", CEP Brexit Analysis, No.2, Centre for Economic Performance, LSE, April.

foreign investors are allocated to projects with a maximised potential for feasibility and local benefits. The British government should therefore make sure that it focuses on the major projects of education and modernisation of infrastructures, because the new economy and high-tech sectors will require significant numbers of managers and engineers. It could thus eradicate the worrying decline of national productivity.

Overcoming these challenges is all the more vital in the wake of Brexit. While the British economy still presents numerous advantages in the eyes of investors in terms of tax, red tape and labour market flexibility, exit from the European Union risks making the country a great deal less attractive. The United Kingdom’s strong dependence on FDI also obliges the British government to negotiate compensation agreements with major foreign groups in the event of a “hard” Brexit, and to implement an aggressive tax policy in order to keep them. These measures are likely to weigh heavily on public finances. This raises questions about the United Kingdom’s capacity to pursue a long-term industrial strategy based on technological innovation, a target set by Theresa May to guarantee the country a successful exit from the EU.

About the author

Louisa toubal is economist. She holds a master degree in International Economics from the University of Paris1, Panthéon-Sorbonne. She spent the first year of her Master at the Caledonian University of Glasgow where she specialized in the field of European Business.
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