in brief...

Brexit and outward investment by UK firms

Media reports have highlighted that some UK firms have started to move production abroad in anticipation of Brexit. CEP analysis confirms that there has indeed been a substantial increase in outward investments. The shift is entirely driven by the services sector, perhaps because Brexit negotiations have made manufacturing the priority.

The UK's vote to leave the European Union (EU) has generated fears that UK firms are moving investment abroad because of Brexit. For example, media reports have documented that both large UK companies, such as Barclays, EasyJet and HSBC, and smaller companies, such as Crust & Crumb, a Northern Irish pizza-maker, have invested in the remaining EU member states (the EU27) in response to Brexit.

Has the threat of reduced access to the EU market after Brexit pushed UK firms into setting up shop in the EU27 rather than serving those markets from the UK? Our research examines whether the anecdotal evidence is representative of a wider pattern.

We measure new foreign direct investment (FDI) projects by UK firms through a count of announced greenfield and M&A (mergers and acquisitions) transactions. Greenfield activity refers to investments that create new establishments or production facilities from scratch, for example, setting up a new factory. M&A transactions refer to the acquisition of existing facilities.

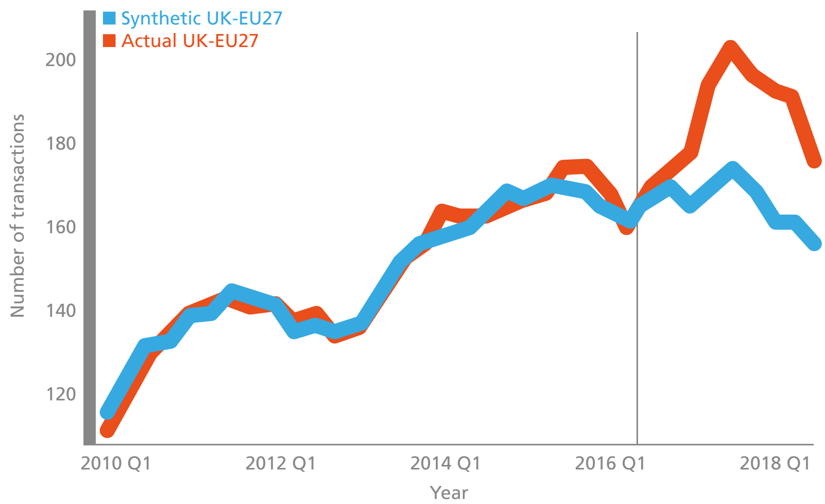
Our analysis focuses on the period from 2010 to 2018, during which we observe around 100,000 transactions in total.

The doppelgänger method

We employ the 'synthetic control' or 'doppelgänger method' to analyse the impact of the Brexit vote. This is a way to estimate how UK FDI flows to the EU27 would have evolved after the June 2016 referendum if the UK had not voted for Brexit.

We construct a doppelgänger for UK FDI as a weighted average of FDI transactions between other developed countries, with FDI into the EU27 from Switzerland and the United States receiving the biggest weights. If the

Figure 1:
Number of foreign direct investment transactions by UK firms in the EU27



Note: This plots the actual count of FDI transactions from the UK to the EU27 (red line) and the corresponding doppelgänger series (blue line).
Source: fDi Markets, Zeyphyr and authors' calculations.

The Brexit vote has led to a 12% increase in the number of new investments made by UK firms in EU27 countries

There is no sign of a 'Global Britain' effect: UK firms are not investing more in advanced countries outside the EU

referendum outcome has had no discernible impact on UK FDI, then the doppelgänger and the actual series should be similar not only before, but also after the referendum.

The referendum increased foreign investment from the UK into the EU27

Figure 1 shows our results. The number of FDI transactions from the UK into the EU27 went up substantially after the second quarter of 2016 compared with the synthetic doppelgänger, which remains at 2014 and 2015 levels.

In terms of the cumulative difference, we find that 181 greenfield and M&A transactions from the UK into the EU27 had taken place by the third quarter of 2018 that would not have occurred in the absence of Brexit. This represents a 12% increase in new FDI projects by UK firms in the EU27.

In further analysis, we show that the increase in outward FDI from the UK to the EU27 is entirely driven by the services sector. This finding could be a consequence of the fact that the UK government has made the interests of manufacturing a priority over services in the Brexit negotiations. It has done this by focusing on reducing customs frictions, while ruling out membership of the EU's single market.

An alternative explanation is that it may simply be easier to set up new foreign affiliates in services than in manufacturing.

In terms of value, we estimate that these additional FDI outflows from the UK to the EU27 are worth approximately £8.3 billion in total by the third quarter of 2018. Moreover, the persistence of the gap in Figure 1 shows that the referendum effect has not yet died away, indicating that the increase in outward FDI due to Brexit is likely to grow further as more data become available.

As a note of caution, we stress that the FDI outflows can only be interpreted as 'lost investment' for the UK under the assumption that the investment transactions would have taken place in the UK, instead of the EU27, were it not for the leave vote. It could also be that the referendum outcome simply triggered additional investment by UK firms in the EU27. We therefore regard £8.3 billion as an upper bound on lost investment.

No 'Global Britain' effect

Is the increase in FDI from the UK specific to the EU27 as a destination, or do we observe similar changes in UK investment flows to other countries? To evaluate this possibility, we construct a doppelgänger for UK investment into non-EU OECD countries.

In contrast to the EU27 as a destination, we do not observe an increase in UK investment activity into these non-EU OECD countries. In other words, UK investment in advanced economies outside the EU27 has not experienced a post-referendum surge – there is no sign of a 'Global Britain' effect.

Finally, we show that increased outward investment in the EU27 has been accompanied by lower investment coming into the UK from the EU27. We estimate that the referendum reduced the number of new EU27 investments in the UK by 11%, amounting to £3.5 billion of lost investment.

Conclusion

We show that the Brexit vote has led to a 12% increase in the number of new investments made by UK firms in EU27 countries. We find no such increase in UK investment in advanced countries outside the EU.

Although it is not possible to be certain about the reasons behind firms' investment decisions, our results are consistent with the idea that UK firms are offshoring production to the EU27 because they expect Brexit to increase barriers to trade and migration, making the UK a less attractive place to do business.

In the event of a 'no-deal Brexit', more firms are likely to activate contingency plans for moving production abroad, accelerating the outflow of investment from the UK.

This article summarises 'Voting with their Money: Brexit and Outward Investment by UK Firms' by Holger Breinlich, Elsa Leromain, Dennis Novy and Thomas Sampson, CEP Brexit Analysis No. 13 (http://cep.lse.ac.uk/pubs/download/brexit13.pdf).

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