Office for National Statistics

Article

International perspective on UK foreign direct investment (FDI): 2014

This short article outlines the importance of FDI and presents data on UK FDI stocks and compares them to those of other advanced economies.

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1. Acknowledgements

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2. Introduction

Foreign Direct Investment (FDI) refers to cross-border investments made by residents and businesses from one country into another, with the aim of establishing a lasting investment in the company receiving investment. In this short article, the importance of FDI is discussed, before data on UK FDI stocks are presented and compared to other advanced economies.

3. Why is foreign direct investment important?

The importance of FDI has grown rapidly in recent decades because of ever-increasing globalisation. As such, the role FDI plays in establishing lasting links between economies, promoting technological transfers and innovation, and in providing investors with access to previously inaccessible markets has resulted in FDI statistics becoming a key focus for many governments, financial analysts and academics.

An important role of FDI statistics is to monitor a country's financial transactions with the rest of the world. FDI statistics are a key component of a country's balance of payments: FDI earnings are part of a country's current account, which indicates whether a country is a net lender or borrower to the rest of the world; FDI flows are part of a country's financial account, which reports on capital flows to and from a country; and FDI positions are part of a country's overall international investment position, which reports on the stock of investment the country holds overseas, and the stock of investment overseas investors hold in a country.

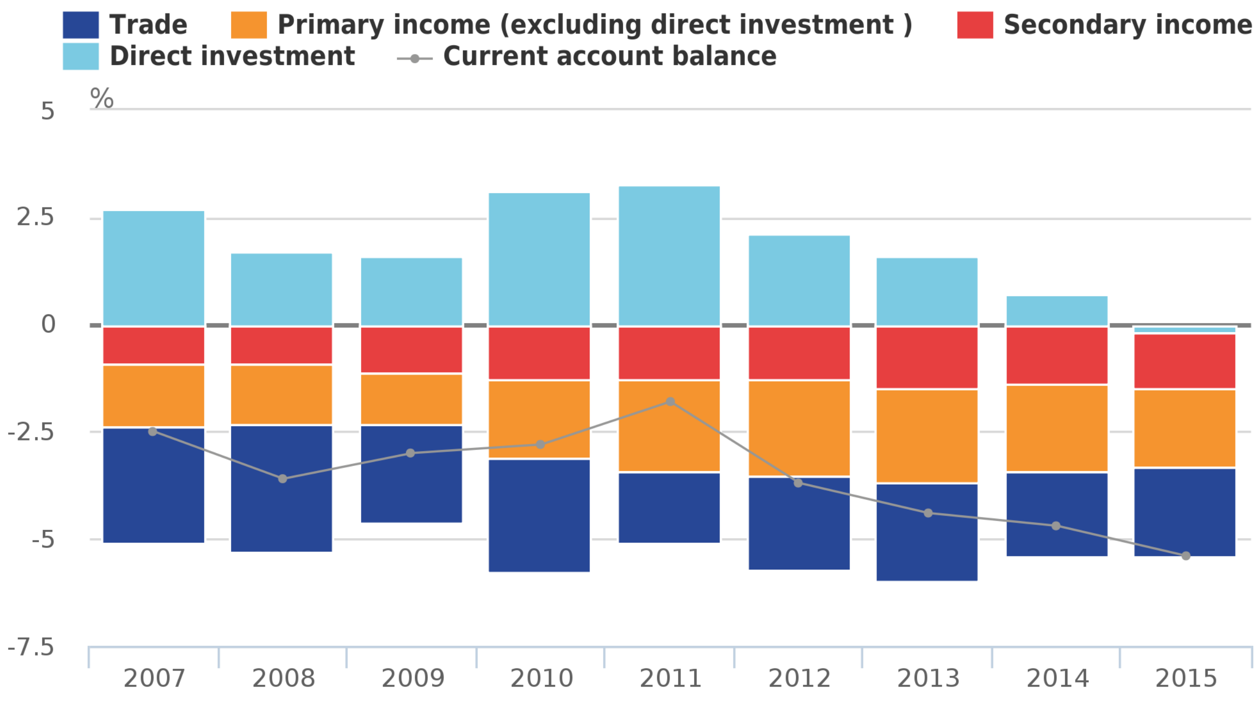
Interest in FDI by policymakers has increased in recent years, which reflects the potential positive effects FDI can have on a country's productivity and wages. FDI is believed to increase the productive capacity of a country through not only increasing capital investment, but also through transfers of technology, skills and better management. As such, firms in receipt of FDI are believed to be more productive and to offer higher wages. Additionally, FDI into the UK has also been found to have increased employment; since 2010, FDI activities have created more than 220,000 jobs in the UK (Department for Business, Energy and Industrial Strategy, 2014).

4. Foreign direct investment and the current account

FDI is a key component of primary income in the current account, where credits refer to the amount UK investors generate from investments held in overseas territories (outward direct investment), and debits refer to the amount overseas investors generate from investments held in the UK (inward direct investment).

The UK's current account balance has remained in deficit for over 3 decades, despite the traditionally positive contributions made from FDI, where the amount UK investors received from overseas exceeded the amount overseas investors generated in the UK. However, falls in the FDI earnings balance since 2011, which entered negative territory for the first time in 2015, accounted for a large proportion of the recent decline in the UK's current account. This reached a record high of 5.4% of GDP in 2015, as shown in Figure 1.

Figure 1: UK current account balance and components, 2007 to 2015



Source: Office for National Statistics

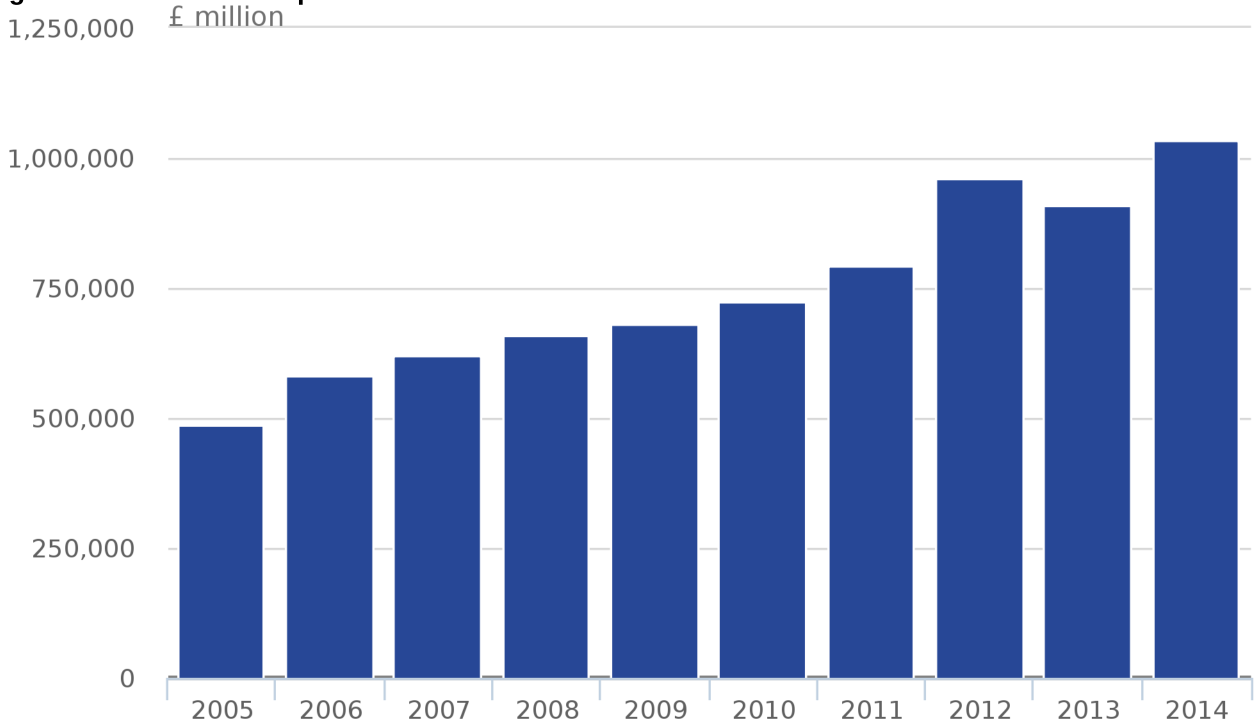
These recent deteriorations in the UK current account have resulted in increased interest in FDI statistics and the current account, which has been referred to as the UK's "second deficit". The UK's current account deficit indicates that the economy is a net borrower from the rest of the world, and that it must be financing its deficit through either selling its overseas assets or acquiring new liabilities. It is worth noting that a deficit in itself is not necessarily a cause for concern as long as it can be financed; however, it does highlight a potential macroeconomic risk to the economy should foreign investors lose their appetite for UK-based investments.

5. UK foreign direct investment positions

Our FDI statistics report on the value of the stock of investment in the UK from overseas investors (inward FDI) and the value of the stock of investment abroad by the UK investors (outward FDI). These statistics are reported on both an industry and country level.

The value of direct investment held in the UK by overseas investors (inward FDI positions) has followed a broadly upward trend for a number of years, and increased further in 2014 to £1,034.3 billion, up from £910.3 billion in 2013, as shown in Figure 2. The increase highlights continued appetite for UK-based investment by overseas investors.

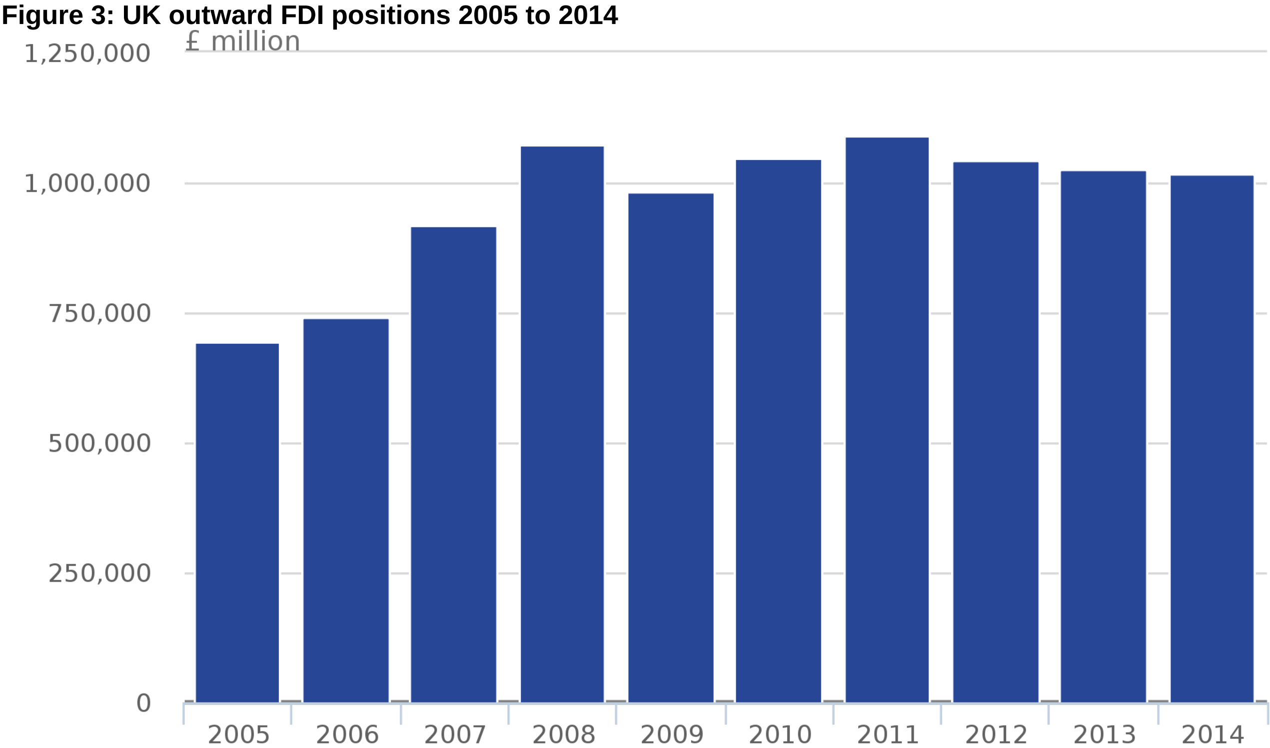
Figure 2: UK inward FDI positions 2005 to 2014



Source: Office for National Statistics

The value of UK direct investment abroad (outward FDI positions) has declined in each year since 2011, and fell further in 2014 to £1,015.4 billion in 2014, down from £1,024.6 billion in 2013. The decline coincides with falling rates of return UK investors generate abroad, suggesting they are disinvesting.

Figure 3: UK outward FDI positions 2005 to 2014

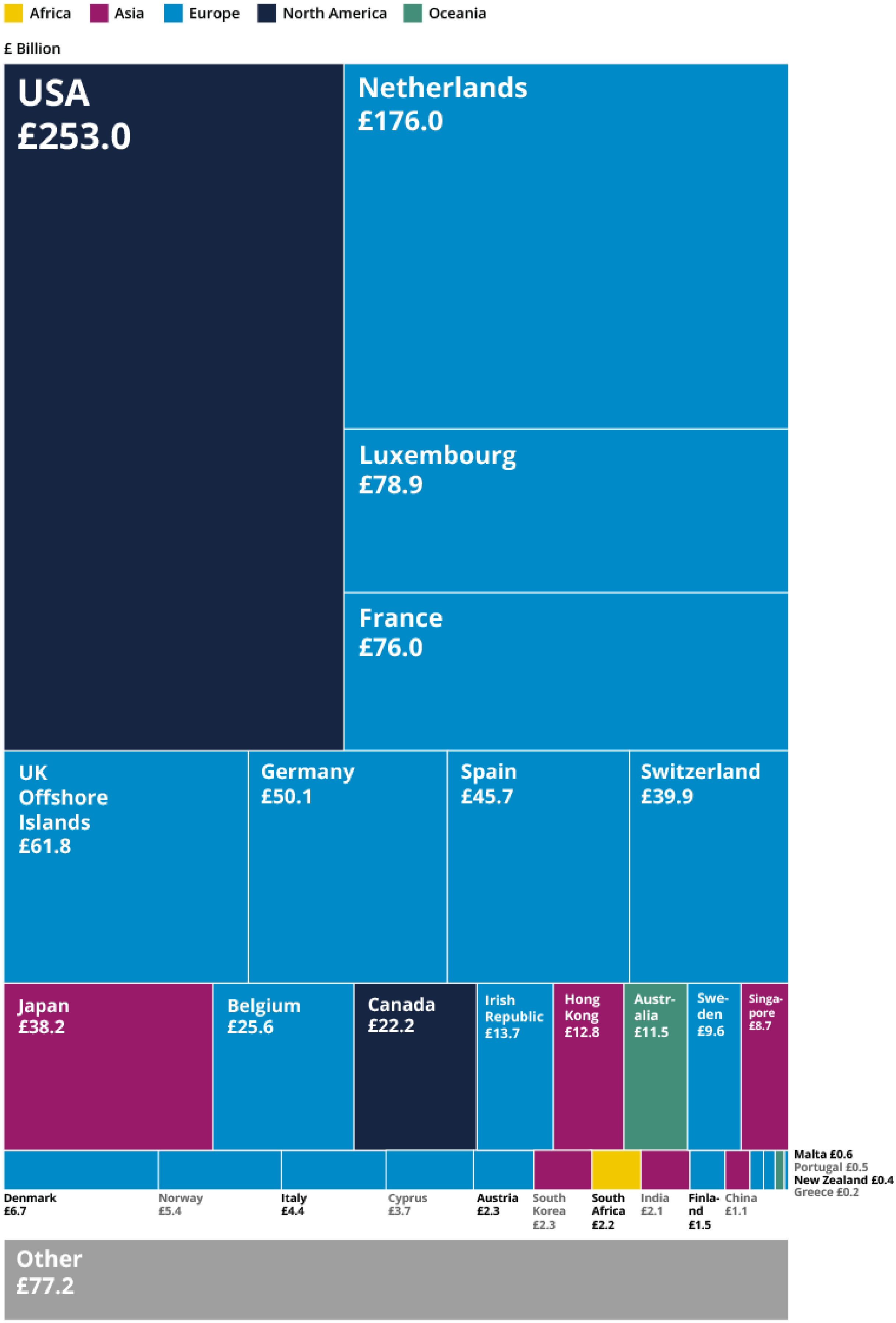


Source: Office for National Statistics

6. Foreign direct investment positions in the UK by geography

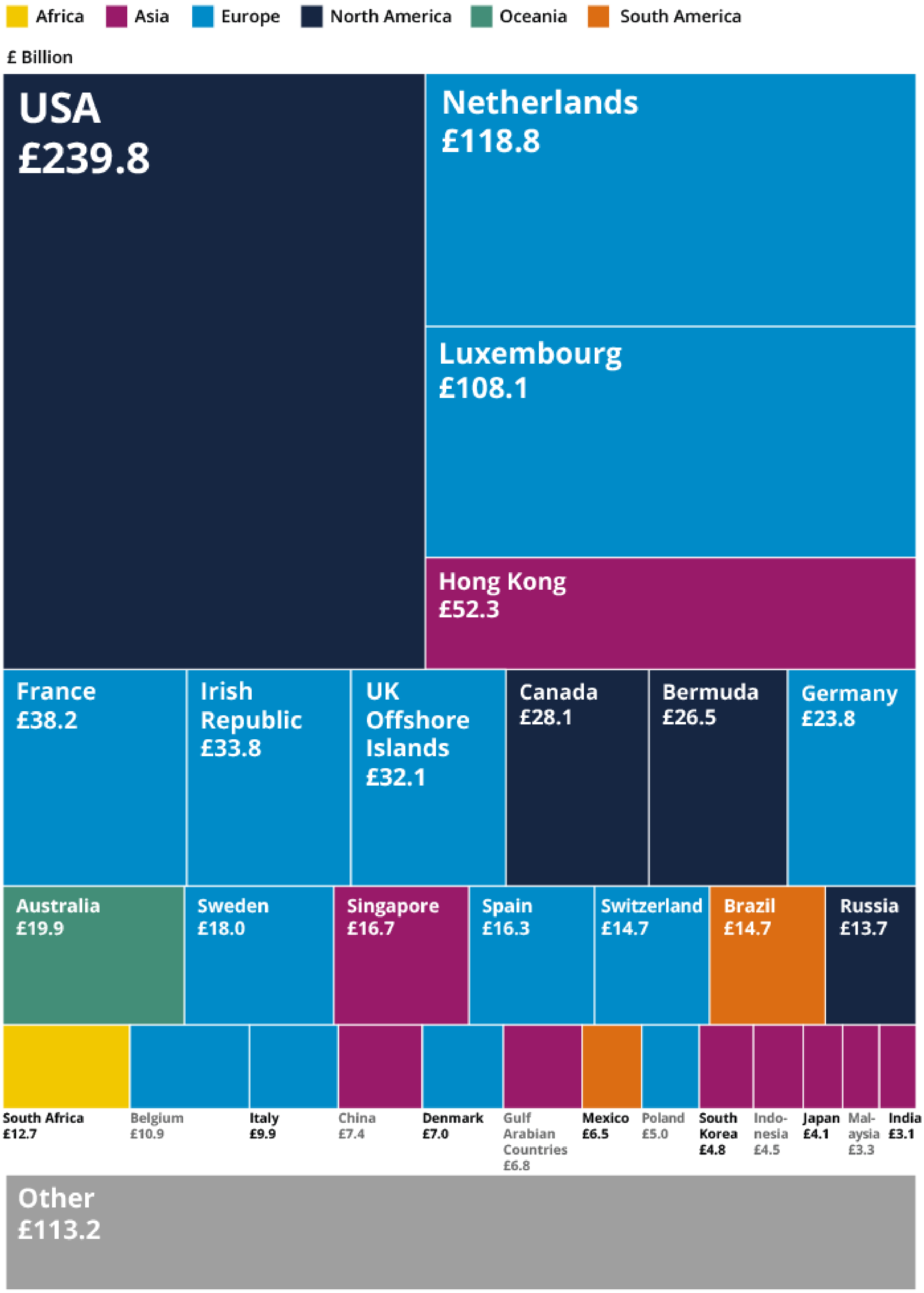
Looking at both inward and outward FDI positions by destination helps indicate the UK's investment relationships with the rest of the world, while the performance of the underlying economies in which these investments come from or are held can explain changes in performance in those assets. In terms of foreign direct investment stocks in the UK, the largest sources of investment in 2014 were the USA (£253.0 billion), Netherlands (£176.0 billion), Luxembourg (£78.9 billion), France (£76.0 billion) and Germany (£50.1 billion). Treating the EU as a single region makes it the largest source of UK investment, with a value of £495.8 billion, or 47.9% of total UK inward investment.

Figure 4: UK FDI inward positions 2014



In terms of UK direct investment abroad, the largest destinations for UK overseas direct investment stocks in 2014 were USA (£239.8 billion), Netherlands (£118.8 billion), Luxembourg (£108.1 billion) and Hong Kong (£52.3 billion). Treating the EU as a single region makes it the largest destination for UK investment, with a value of £404.2 billion, or 39.8% of total UK outward investment.

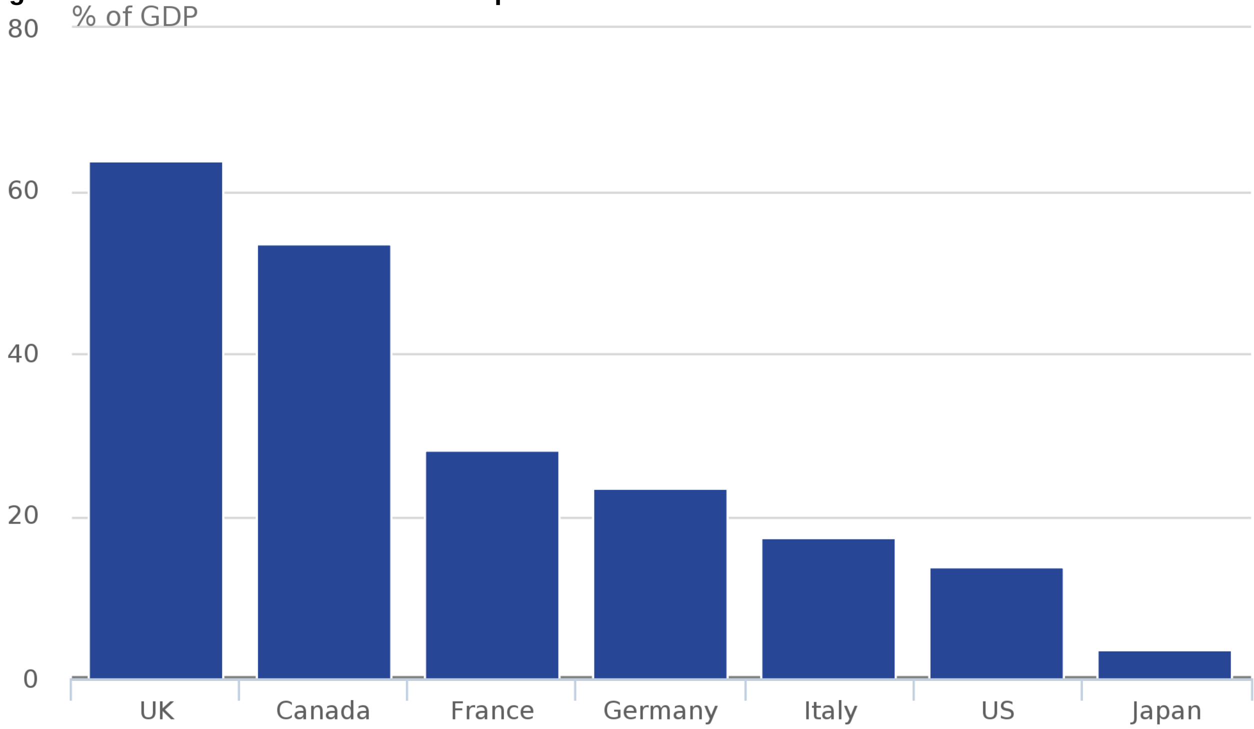
Figure 5: UK FDI outward positions 2014



Comparing UK FDI to the G7 countries allows for relative comparisons to be made, allowing users to view UK FDI figures in an international perspective.

Figure 6 presents the value of inward FDI stocks of G7 economies – a grouping of 7 advanced industrialised economies. Of this grouping, the UK is shown to have had the highest percentage of inward FDI as a percentage of GDP, which stood at 63.7% of GDP in 2014.

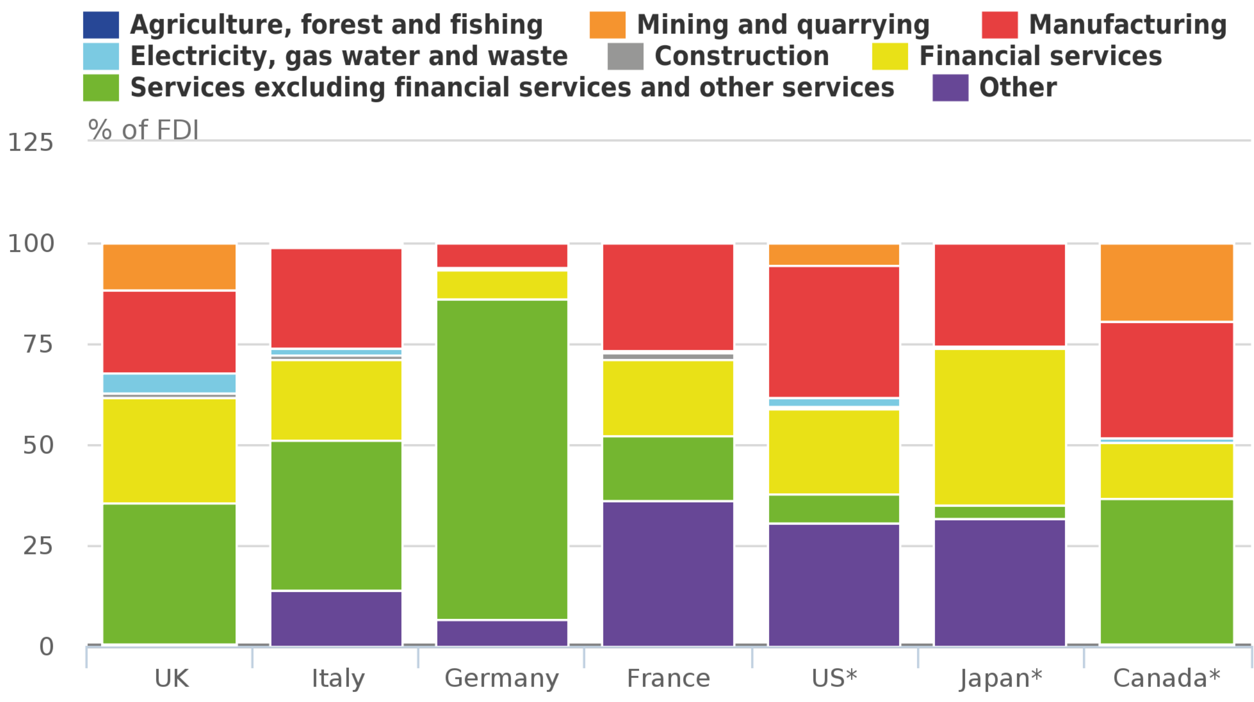
Figure 6: G7 Countries 2014 inward FDI positions



Source: Office for National Statistics - Eurostat and OECD Stats

Figure 7 provides an industry breakdown of inward FDI. UK services play an important role, accounting for 61.2% of FDI stocks in the UK, with 26.1% of this devoted to financial services alone. The manufacturing industries are the next largest receiver of inward FDI (20.3%), followed by the mining and quarrying industries (11.5%). In terms of inward FDI, Canada has the most similar industry breakdown to the UK out of the G7 countries, although they have less investment in services and more in manufacturing and mining and quarrying.

Figure 7: G7 Countries' 2012 inward FDI positions – industry breakdown



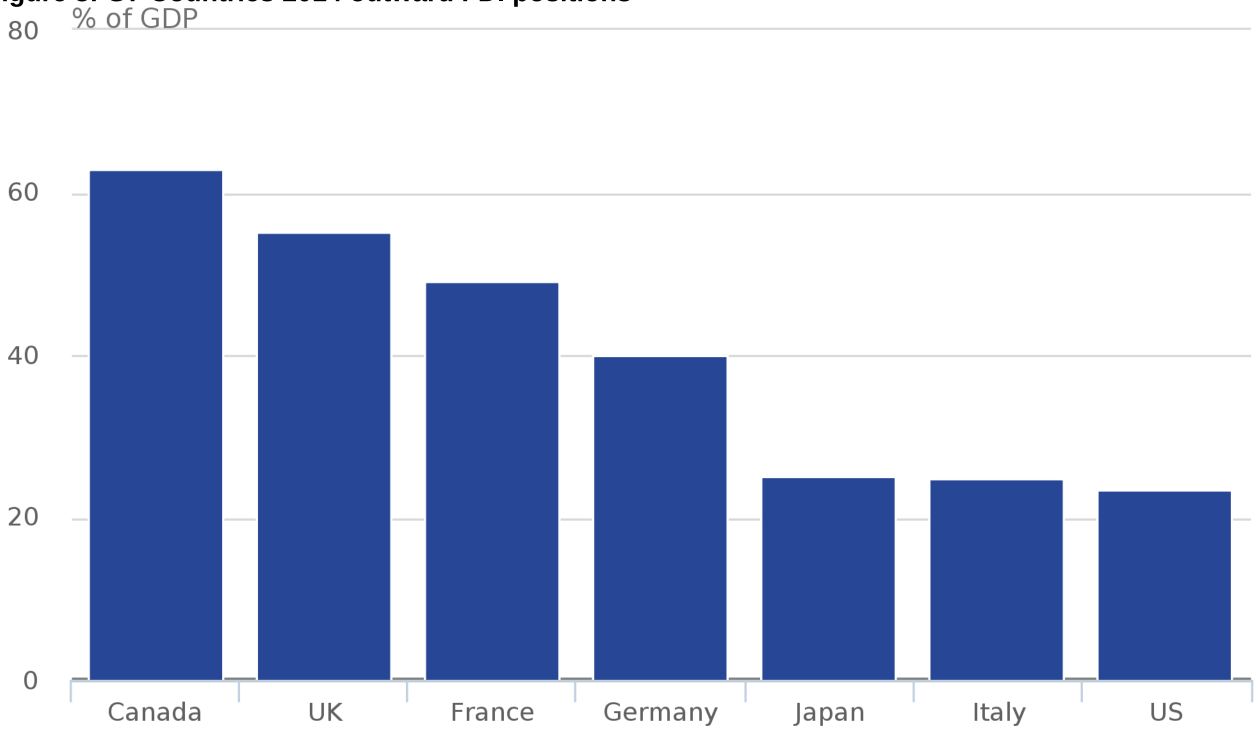
Source: Office for National Statistics - Eurostat and OECD Stats

Notes:

1. US, Japan and Canada data are for 2011, Other includes public corporations, property data, bank holdings and monetary financial institutions (MFI).

Figure 8 presents the value of outward FDI stocks of the G7 economies. Of this grouping, the UK is shown to have the second highest percentage of outward FDI as a percentage of GDP, which stood at 55.2% of GDP in 2014, 7.6 percentage points fewer than Canada.

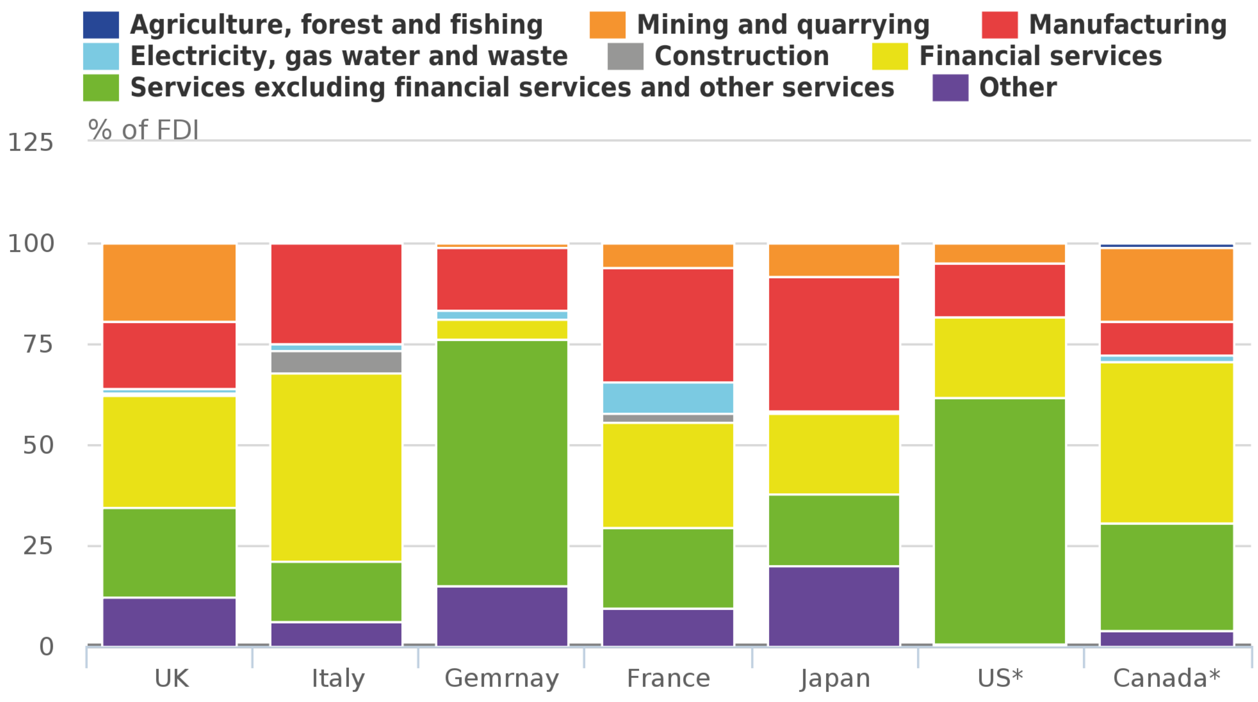
Figure 8: G7 Countries 2014 outward FDI positions



Source: Office for National Statistics - Eurostat and OECD Stats

Figure 9 provides us with an industry breakdown of outward FDI; similarly to inward FDI, services are a key industry for outward FDI in the UK, accounting for 50.1% of the UK's overseas FDI stocks. The mining and quarrying industries are the next largest industry for outward UK FDI (19.4%), followed by manufacturing (16.6%). In terms of outward FDI, Canada has the most similar industry breakdown out of the G7 to the UK; however, their investment in financial services is larger and manufacturing is smaller.

Figure 9: G7 countries 2012 outward FDI positions – industry breakdown



Source: Office for National Statistics - Eurostat and OECD Stats

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1. US and Canada data are for 2011, other includes public corporations, property data, bank holdings and monetary financial institutions (MFI).