FDI in uncertain times: did the UK's regional IPAs help protect inward FDI during the Brexit negotiation period?

Juan Alvarez-Vilanova FEBRUARY 2025

London School of Economics & Political Science

ABSTRACT

Economic uncertainty is known to deter Foreign Direct Investment (FDI), and the Brexit negotiation period was no exception. Yet, regional institutions, particularly Investment Promotion Agencies (IPAs), are increasingly leveraging ecosystem-building strategies to embed multinational enterprises (MNEs) in priority sectors, potentially insulating FDI from adverse shocks. This paper investigates whether such strategies provided resilience during Brexit uncertainty, exploring a less-examined channel through which IPAs can grow FDI: not just by attracting new investment, but by strengthening embeddedness of established investors. Using a unique dataset on UK IPAs' sector-specific FDI strategies, I assess the impact of pre-2015 sector-targeting efforts on FDI outcomes during the 2016–2019 Brexit negotiation period. My findings reveal that pre-Brexit IPA sector-targeting was associated with a 13.9% increase in repeat investment value and a 19.3% rise in job creation within Knowledge-Intensive Services (KIS) sectors. However, no such effects were observed for manufacturing, likely due to the acute trade-related uncertainty in those industries. Moreover, and contrary to previous research into IPA impacts on FDI, no effects were observed for new FDI – that is, investments by MNEs that are new to the region – either in KIS sectors or manufacturing. This likely reflects how, in times of uncertainty, the ecosystem-embedding activities of IPAs – which by definition focus more on *established* MNE investors – may prove more significant than their role in supporting *new* MNE investors to enter a regional market. In the current global context of continued economic uncertainty and turbulence, these findings are particularly informative for policy-makers seeking to protect vital regional FDI.

EXTENDED ABSTRACT

Investment Promotion Agencies (IPAs) have emerged as a key policy tool for countries and regions to grow Foreign Direct Investment (FDI) and harness the benefits of internationalisation more broadly (World Bank, 2023). In fact, in the current era of near-constant and often overlapping shocks to global economic connectivity, plus the pressing need to bring about a green and digital transition of the economy, the potential role of policy levers like IPAs – often beyond their traditional mandates – has only garnered more attention (OECD, 2023; Crescenzi & Harman, 2023).

In the UK context, undoubtedly one of the most significant such shocks was the largely unexpected 'Brexit' outcome of the UK's 2016 referendum on European Union (EU) membership. Even before the UK formally left the EU in January 2020, the uncertainty that emerged for Multinational Enterprises (MNEs) while Brexit was negotiated, particularly regarding the possibility of losing access to the EU single market, represented a significant threat to investment in the UK (Bloom et al, 2019), particularly in the form of FDI (Dhingra et al, 2018). A well-established literature has explained how such uncertainty can act as a 'tax' that disincentivises investing abroad (Dunning & Lundan, 2008; Buchanan et al, 2012), and empirical research has indeed shown that the UK saw lower FDI inflows in the years following the Brexit referendum (comparing to a scenario where Brexit had not happened) (Serwicka & Tamberi, 2018).

That said, institutions can play a major role in tackling this uncertainty (North, 1990) and/or cultivating a country or region's resistance to it (Rodrik, 2007). In the Brexit context, the well-documented fact that inward FDI impacts varied significantly by region (Driffield et al, 2023) begs the question of whether regional institutions active in some places but not others played any role in mitigating the negative impacts of uncertainty.

The objective of this paper is to investigate whether this is the case, in so doing contributing to a gap in the literature around how and to what extent regional institutions can support the forging of fruitful connections between MNEs and regions, which has been termed a 'black box' in the literature (Yeung, 2021; Hill et al, 2011; Gong & Hassink, 2019). In particular, I explore a less-explored via which regional institutions like IPA may support regional FDI: by acting in the 'good times' to embed MNEs and their FDI within regional ecosystems, so that they are more resistant and likely to maintain (or expand) their investment in the 'bad times'. Beyond providing information and assistance to support the entry of new FDI (Morisset, 2003; Harding & Javorcik, 2011), I posit that UK IPAs' efforts to embed *establish*ed MNE investors through a number of ecosystem-building activities constitutes a key channel for regional FDI growth, and one which is arguably more relevant in the current global context of near-constant uncertainty.

To do this, I exploit a unique dataset of UK IPAs' sector-specific FDI strategies collected via the EU-funded MASSIVE survey (Crescenzi, Di Cataldo & Giua, 2018). I focus on the potential impact that such IPAs may have had on inward FDI not via their direct actions during the Brexit uncertainty period, but by the heterogeneous sector-targeting strategies in place *before* 2015 (before Brexit was even contemplated). I suggest that the ecosystem-building activities that these strategies increasingly entail provides MNE investors with access to regional assets such that, in the face of costly uncertainty, the option to (re)invest remains attractive. In a context of uncertainty, I hypothesise that such effects are more likely to concentrate in the form of relatively higher repeat investment/expansions by MNEs in targeted region-sectors, and that this will be especially the case in KIS sectors.

Preliminary results

My empirical analysis, which takes the form of a Two-Way Fixed Effect (TWFE) regression and event study analysis on regional FDI outcomes during the 2016-2019 Brexit uncertainty period, provides evidence in favour of my hypotheses. Compared to my counterfactual region-sectors, I find that pre-2015 Brexit sector-targeting strategies were indeed effective at increasing inward FDI in the form of KIS sector expansions (but not expansions in the manufacturing sector). As shown in Table 1, below, these results are statistically significant for measures of FDI both at the intensive margin – FDI project value and associated job creation – and extensive margin – the probability of an FDI project in a region-sector. As my outcomes are transformed via the Inverse Hyperbolic Since method, they can be interpreted as follows: a region-sector that was targeted pre-Brexit vote received average inward FDI in the form of KIS repeat investment that was 13.9% higher in terms of value and 19.3% in terms of job creation, compared to non-targeted region-sectors. Specifying my regression as an event study supports that these effects are not in fact driven by pre-trends, as shown in the Appendix below.

Table 1: Regression results for repeat FDI: KIS sectors (panel A) and manufacturing (panel B)

Panel A: KIS sectors

	(1)	(2)	(3)	(4)	(5)	(6)
VARIABLES	Dummy – FDI exp.	Dummy – FDI exp.	FDI value	FDI value	FDI jobs	FDI jobs
pre-2015 IPA target X post-Brexit ref.	0.0236*	0.0336*	0.0985*	0.1389**	0.1391*	0.1932**
	(0.0129)	(0.0174)	(0.0537)	(0.0670)	(0.0712)	(0.0885)
Post2015 IPA targeting	0.0400	0.0418	0.1901*	0.2021**	0.2158*	0.2207*
	(0.0263)	(0.0275)	(0.0996)	(0.1012)	(0.1259)	(0.1306)
Constant	0.0496***	0.0487***	0.1753***	0.1716***	0.2379***	0.2331***
	(0.0012)	(0.0016)	(0.0050)	(0.0062)	(0.0066)	(0.0082)
12-month period FE	x	x	x	x	x	x
Region-sector FE	x	x	x	x	x	x
Sector-12-month period FE		x		x		x
Region-12-month period FE		x		x		x
Observations	7,560	7,560	7,560	7,560	7,560	7,560
R-squared	0.4717	0.5309	0.5298	0.5880	0.5176	0.5768

Robust standard errors in parentheses; *** p<0.01, ** p<0.05, * p<0.1. For specifications 3-6, the outcome is transformed via the Inverse Hyperbolic Sine (IHS) method.

Panel B: Manufacturing sectors

	(1)	(2)	(3)	(4)	(5)	(6)
VARIABLES	Dummy – FDI exp.	Dummy – FDI exp.	FDI value	FDI value	FDI jobs	FDI jobs
pre-2015 IPA target X post-Brexit ref.	0.0115	0.0211	-0.0038	0.0463	0.0462	0.0961
	(0.0135)	(0.0203)	(0.0618)	(0.0934)	(0.0700)	(0.1054)
Post2015 IPA targeting	-0.0185	-0.0235	-0.0559	-0.0930	-0.1184	-0.1623*
	(0.0156)	(0.0184)	(0.0754)	(0.0799)	(0.0927)	(0.0938)
Constant	0.0482***	0.0475***	0.2104***	0.2066***	0.2471***	0.2435***
	(0.0012)	(0.0018)	(0.0056)	(0.0084)	(0.0064)	(0.0095)
12-month period FE	x	x	x	x	x	x
Region-sector FE	x	x	x	x	x	x
Sector-12-month period FE		x		x		x
Region-12-month period FE		x		x		x
Observations	7,560	7,560	7,560	7,560	7,560	7,560
R-squared	0.2966	0.3598	0.3142	0.3780	0.3078	0.3701

Robust standard errors in parentheses; *** p<0.01, ** p<0.05, * p<0.1. For specifications 3-6, the outcome is transformed via the Inverse Hyperbolic Sine (IHS) method.

These results suggest that UK IPAs' sector targeting strategies were effective at growing inward FDI only in those sectors that were less exposed to Brexit-related trade uncertainty to begin with, and by MNEs that were already established in the region and therefore able to benefit from the pre-Brexit ecosystem-building activities of IPAs. Conversely, the absence of any positive impacts for manufacturing FDI (or new FDI more broadly) reflects the gravity of the uncertainty shock caused by Brexit, against which any IPA-derived benefit would be insufficient to tip the balance in favour of committing to FDI in a given region.

Preliminary conclusions

This paper contributes to our understanding of how regional institutions – and IPAs in particular – can help to support the broader aims of regions vis-à-vis internationalization, namely to attract quality, durable investments that can foster regional resilience to shocks. In so doing, I provide empirical evidence for a less-explored channel through which IPAs can contribute toward regional FDI growth: by cultivating the embeddedness of established MNE firms during the 'good times', so that they are more resistant to costly uncertainty in the 'bad times'. Contrary to previous research into IPA impacts on FDI, I find no effects for new FDI – that is, investments by MNEs that are new to the region – either in KIS sectors or manufacturing. This likely reflects how, in times of uncertainty, the ecosystem-embedding activities of IPAs – which by definition focus more on *established* MNE investors – may prove more significant than their role in supporting *new* MNE investors to enter a regional market. Therefore, in a new normal of near-constant uncertainty shocks affecting MNE investors, efforts to embed existing FDI into regional ecosystems may prove a particularly effective channel through which regional institutions can seek to protect regional investments.

However, much more research is needed, particularly with regards to disentangling exactly which type of ecosystem-building activities are associated with better embedding of FDI, and how this varies by sector. As data becomes increasingly available, both in terms of what exactly IPA strategies entail (i.e., beyond the sector) and in terms of the greater information available regarding individual FDI projects, addressing some of these questions is becoming more feasible, and researchers should take note.

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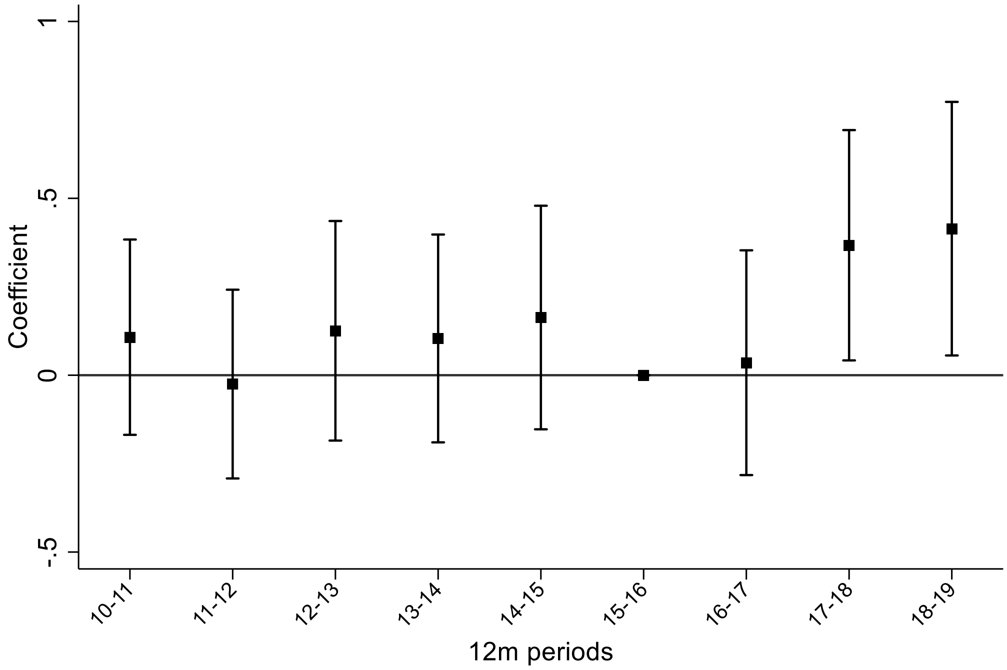
Appendix: Event studies

Impact of treatment by 12month period, on FDI capital value



Impact of treatment by 12month period, on FDI job creation