Margaret Sharp

Inward Investment and Industrial Competitiveness

Inward investment — foreign direct investment in subsidiaries and joint ventures — has played an important part in Europe's post-war development as multinational firms, particularly American multinationals, became a major feature of many European economies. Latterly, we have seen an increasing presence also from Japan and other South-East Asian countries, as well as a resurgence of intra-European investment. What has been the effect of this on the competitiveness of European industry?

The research project on which this article is based began with a conundrum. Studies in the UK revealed that whereas the high level of foreign penetration had tended to stimulate the competitiveness of major UK pharmaceutical firms, it had no such effect on major UK firms involved in the offshore supplies industry. Why should this have been? And how far did this same, varied experience hold true for other industrial sectors and other countries? To help answer these questions we extended the study to cover the semiconductor and consumer electronics sectors, and we examined the role of inward investment in these sectors not just in the UK, but also in other European countries.

Trends in Net Investment

It is helpful to begin with some figures illustrating trends and relativities. Table 1 shows inward investment flows as a percentage of outward flows and therefore illustrates how far a country has been a net recipient or a net lender in terms of direct investment. Using this measure overcomes problems of allowing for both exchange rate fluctuations and inflation while at the same time illustrating developments over a twenty-five year period.

Three important trends stand out. First, the demise of the United States as a substantial net investor. Second, the shift of West Germany and Japan from the status of debtor to creditor nations. The third trend relates to the UK. Even in the 1960's the UK was, like the US, a net exporter of capital, but in contrast to the position of the US, in the last decade Britain has become a major net investor overseas.

Japanese companies may have become major investors overseas, but cumulatively their share remains very small beside that of the US. Tables 2 and 3 reveal the cumulative totals of direct investment into Western Europe from the two countries. It is noteworthy that Japan's total in 1985 was only 10 per cent of that of the US but that for both countries the major recipient has been the UK with approximately 30 per cent of the total from each country whereas the next highest shares are only half this figure.

Finally, it is worth looking at the sectoral breakdown figures in Tables 4 and 5. The US figures, although less detailed than the Japanese, give the trend over time and

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reveal the relative decline of manufacturing as the main recipient sector and the rise of the service sector. The Japanese figures show a marked preference for commerce and construction over manufacturing, echoing perhaps the relatively early stage at which Japanese foreign investment still finds itself, with much of the investment being directed towards the setting up of distribution and service outlets. Of the 19 per cent investment that has gone into manufacturing facilities, there is some bias, but not as marked as one might expect, towards electronics and transport equipment (cars).

Post-war National Policies

The dollar shortages of the early post-war years first led European governments to encourage US multinationals to expand their presence in Europe. The UK with its language and cultural affinities was the favoured location (reinforced by generous subsidies encouraging location in the less prosperous regions), followed by the Benelux countries whose geographical position was favourable for distribution throughout mainland Europe. Inevitably the large and fast growing market of West Germany also attracted the multinationals.

The recession of the 1970’s and the rising levels of unemployment brought a major change in emphasis. Substantial incentives encouraging location were no longer confined to the less prosperous areas of the UK or the Benelux countries, but were offered by practically every region of Europe.

The deep recession of the early 1980’s brought a change in attitude – partly, it must be acknowledged, as a result of the changing types of investment project. The typical inward investment project is no longer the branch plant of an American manufacturing giant. If it is American, it tends either to be in the service sectors, or, if in manufacturing, the offspring of a small company producing specialised components at the high-tech end of manufacturing. Mass production manufacture now tends to be the preserve of Japanese or Far Eastern companies, typically in consumer electronics, evading voluntary export restraints. In the meantime many of the major firms who established large manufacturing subsidiaries in the 1930’s and post-war years – firms such as Singer, Chrysler and Goodyear – have first rationalised their activities and subsequently withdrawn from European operations altogether as their own manufacturing base in North America has come under threat.2

National policies have changed in belated recognition of the changing global competitive challenge. For the British government there has been a retreat from the indiscriminate “open door” policy of the 1970’s, as illustrated by the tough terms negotiated with Nissan over the 1982-84 period.3 The West German federal government, worried by the rise in unemployment particularly in such states as North-Rhine Westphalia, Bavaria and Baden-Wurttemberg, has actively acquiesced to these states’ extending overseas in their efforts to attract foreign capital, although at the same time it was by no means happy at the erosion of the capabilities of the indigenous consumer electronics industry by the Japanese. For the Dutch government, inward investment has offered a chance to diversify away from dependence upon the bulk chemical industry

Table 1

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3 Nissan, who were also in negotiation with the Spanish authorities, made it clear that they would not come to Britain unless they received extra “discretionary” help on top of the automatic regional grants operating at that time. Even so, they were prepared to accept a commitment to 60 per cent local sourcing by 1990 and a long-term target of 80 per cent local sourcing. In negotiating the deal the British government were very conscious that in sluggish markets, Nissan’s plant in the North-East would tend to substitute for British Leyland output; equally, improvement in quality and delivery of components would benefit the British firm as well as its Japanese counterpart. See Financial Times, July 1, 1986. Supplement Nissan in the North East.