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Columbia FDI Perspectives

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Learning from Brexit: what parallels for decoupling from China?

by
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In 2016, the UK voted to exit the European Union, a substantial decoupling from its largest economic partner. Flows of goods were bound to suffer from new tariff and regulatory barriers post-Brexit. Indeed, between 2015 and 2022, UK two-way trade in goods with the EU as a percent of total UK merchandise trade fell from 50% to 41%. Considerable inward FDI to the UK pre-Brexit was likewise premised on free access to the vast EU market. Did inward FDI also suffer? And what about outward FDI from the UK?

Beginning with President Trump's trade war tariffs in 2018, the United States and its allies embarked on a decoupling course with China. In 2019, China's two-way merchandise trade with the United States as a percent of its global merchandise trade was 12.4%; by 2022, the percent had marginally declined to 12.0%. But were Chinese FDI flows adversely affected by US decoupling policy? This *Perspective* assesses the impact of US decoupling from China through the lens of Brexit.

Brexit triggered three forces that shaped subsequent FDI flows:

- Inward FDI was discouraged because the UK platform for accessing the EU market was no longer advantageous.

- Inward FDI may have been temporarily encouraged by the prospect of avoiding post-Brexit tariff and regulatory walls.

- UK outward FDI to the EU was probably encouraged by the post-Brexit walls protecting the EU internal market.

Parallel forces are now shaping Chinese FDI flows:

- Calls by US "China hawks" for total decoupling discourage inward Chinese FDI to serve the US market, but have less impact on FDI to serve European, Japanese or Korean markets.

- Inward FDI serving the Chinese market is encouraged by nationalistic "Made in China" messaging from Beijing.

- Through the Belt-and-Road Initiative, China has enlarged its economic footprint in Latin America, Asia and Africa. More outward FDI to these regions is a natural complement.

- However, invoking CFIUS, the US has barred most new inward FDI from China, and the EU and Canada are selectively skeptical.

What do data on FDI flows say about these forces?

Because FDI plans take time to execute, longer periods seem appropriate to evaluate Brexit's impact. Over 2012-2015, total UK inward FDI flows were US$171 billion. Subsequent to Brexit, over 2018-2021, total UK inward FDI was US$179 billion (2022 data not available). Total flows reflect both discouragement, because the UK was no longer an attractive platform, and encouragement, to jump the post-Brexit wall. Encouragement seems to have been the stronger force, with a slight rise in inward UK FDI between the two periods. This happened despite the 2020-2021 pandemic. While some commentators contend that Brexit will curtail UK inward FDI, a simple before-and-after comparison does not reveal a sharp drop. Furthermore, the UK continues to be Europe's most attractive location for FDI in financial services.

UK outward FDI over 2012-2015 was actually negative, while the total over 2018-2021 reached US$119 billion. Separation from the EU does not appear to have dampened outward UK FDI.

Turning to the China decoupling experience, FDI flows into China during the pre-Trump trade war period 2014-2017 totaled US$503 billion, and in the post-Trump period 2019-2022, US$645 billion. Thus, inward Chinese FDI actually increased after the Trump trade war, despite the pandemic (which interrupted the Chinese economy less than other countries).

As for outward Chinese FDI, regional comparisons are revealing. During 2014-2017, 13% of China's outward FDI was destined for the US and its major allies. The rest reached other regions.

During 2019-2021, the share of China's outward FDI destined for the US and its major allies almost halved to only 7% (2022 data are not available). Globally, however, Chinese outward FDI flows increased during the post-Trump period.

Neither UK nor Chinese inward FDI flows were sharply discouraged by decoupling. Instead, post-decoupling periods experienced a modest rise in inward FDI. It would be premature to conclude that decoupling is a tonic for inward FDI, but contrary to the negative post-decoupling experience of trade flows, inward FDI seems relatively immune. Similarly, neither UK nor Chinese outward FDI flows were conclusively dampened by decoupling events.

The EU did not seek to depress UK FDI flows post-Brexit. By contrast, US "China hawks" wrongly attempt to curtail Chinese FDI flows. Whatever the national security benefits of restricting Western trade and technology flows to China, the same does not apply to FDI. Many FDI inflows to China have nothing to do with US national security but do raise Chinese living standards. Similarly, many Chinese FDI outflows to developing countries help raise standards of living in host countries.

Going forward, the US and China should target their FDI restrictions on core military components. Most FDI delivers commercial, not military, benefits. It makes no sense for US and Chinese officials to foreclose these benefits out of exaggerated "what if" scenarios that restrict FDI for wide swaths of dual use products.

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