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Investment Comparisons

Introduction

In 1994, the economics Nobel Laureate Paul Krugman said, “Productivity isn’t everything but, in the long run, it is almost everything.”

This is the issue of our age, whatever political shenanigans persist. Living standards are not rising for many people because productivity is not rising in absolute, let alone relative, terms.

Productivity is driven by investment. Investment in infrastructure, innovation, people/skills, entrepreneurship and competitiveness. The latest figures from ONS on investment across the major economies do not make pleasant reading.

Moreover, the uncertainty over BREXIT is already negatively affecting supply chains (see FT article on UK-EU supply chains 6/11/17) with continental Europe for 2019 onwards.

The Numbers

GFCF is a measure of net investment on non-financial assets – land, buildings, software, transport equipment and machinery. It is a key component of expenditure on productive capacity and averages about 17% of UK GDP per annum. (Business investment is part of GFCF, excluding investment by government, dwellings and non-produced assets, such as land).

UK gross fixed capital formation (GFCF) fell 18% from peak-to-trough, - more than in any other G7 country - after the 2008 crisis. It took over six years for the United Kingdom to regain its pre-crisis level of GFCF.

Over the last ten years, UK GFCF was the lowest as a percentage of GDP within the OECD. Generally, across the G7, this ratio has not increased beyond pre-crisis levels.

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The Analysis

The large drop in UK investment over the last decade reflects a number of factors:

- the financial crisis itself, with more restricted access to finance after 2008;
- lower growth generally, with trend potential slipping below 2% per annum;
- the consequent existence of spare capacity and an emphasis on 'cheap/flexible' labour rather than productivity-led development;
- more general uncertainty affected by global and national political and economic factors that discouraged long-term planning; and
- saving disincentives through the persistence of ultra-low interest rates and wide uncertainty about policy.

The UK economy's advanced status as a services-dominated country suggests GFCF/GDP is going to be lower than in countries where manufacturing is more prevalent. Nevertheless, in the table of 34 countries produced by the OECD (see below), the UK ranked last. From 1997 Q1 to 2017 Q2, the UK averaged 16.7% compared with 30.8% for South Korea (the highest).

Without government, the UK ratio of GFCF/GDP is 14.3% compared with a G7 average of 17.3%.

GFCF is broken down into dwellings, other buildings/structures, other machinery/equipment and intellectual property products. UK total GFCF divides into 20.1%, 33.2%, 25,9% and 20,4% respectively for these assets, on average over the 1997-2017 period.

Amongst the G7, these ratios rank the UK at 5$^{th=}$, 1st, 4th and 4th respectively. In other words, below average on dwellings, above average on other buildings (offices, hospitals et al) and about average on machinery (such as IT) and IP (R&D/patents).

The issue for UK investment, is not so much the spread of investment but the sheer quantum. Some of this is explained by history – the economic structure we ended up with, but some reflects a present lack of relative aspiration. Low investment = low productivity = low growth = low standards of living. The danger is that BREXIT, with its effects on supply chains and broader trading relationships makes the UK position even worse.

Conclusion

Over the last decade (and before), the UK economy performed weakly amongst the G7 (and even more so amongst the OECD as a whole) in terms of capital investment.

This suggests a long-run competitive disadvantage with regard to productivity-led growth – a deficiency being made worse by a range of current policy and political uncertainties.

The government's "Modern Industrial Strategy" needs to address this issue – hopefully starting with the imminent Budget (22/11/17). But, in the end, given better incentives, it is UK business that can drive relative investment higher.

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Average GFCF as a % of GDP by country,
Quarter 1 (Jan to Mar) 1997 to Quarter 2 (Apr to June) 2017

Country	1997 to 2017
South Korea	30.8
Estonia	28.3
Czech Republic	28.0
Australia	26.5
Slovak Republic	25.9
Latvia	25.0
Japan	24.6
Spain	24.6
Switzerland	24.1
Slovenia	24.0
Ireland	23.7
Austria	23.5
Sweden	22.4
Belgium	22.3
Finland	22.3
Canada	22.2
Norway	22.1
New Zealand	22.1
Iceland	21.8
Portugal	21.7
France	21.7
Colombia	21.5
Lithuania	21.0
Netherlands	20.9
United States	20.8
Denmark	20.6
Germany	20.5
Israel	20.2
Costa Rica	20.2
South Africa	19.8
Greece	19.7
Luxembourg	19.6
Italy	19.6
United Kingdom	16.7

Source OECD