Trends in foreign investments

4

Trends in foreign investments

4.1 Introduction

4.2 Dutch Foreign Direct Investments
- Definitions and methodology FDI
- Development of Dutch FDI flows and stocks
- The knowledge intensity of Dutch FDI

4.3 Foreign controlled enterprises in the Netherlands
- Methodology inward FATS, differences FATS and FDI

4.4 Dutch controlled enterprises outside the European Union
- Methodology Outward FATS

4.5 Conclusions and further research

This chapter presents the latest data and insights about Dutch Foreign Direct Investments, foreign controlled enterprises in the Netherlands, and Dutch controlled enterprises outside the European Union. Dutch Inward FDI is now recovering from the economic crisis, but Outward FDI is still trailing behind. The share of foreign controlled enterprises in the Dutch economy continues to grow. Compared to enterprises in Belgium, Germany or France, Dutch enterprises are very active outside the European Union.

4.1 Introduction

Worldwide foreign investments are growing faster than GDP. They influence the Dutch economy as Dutch enterprises buy foreign enterprises and vice versa. Foreign investments in the Netherlands may introduce new organisational skills, new products and new production processes. These can be transferred to local firms, for example by labour migration (Fortanier 2008). Furthermore, multinationals may drive competition which leads to the survival of only the most productive firms (Alfaro and Chen, 2012). Foreign investments abroad generate possibilities for Dutch multinationals, because the turnover of multinationals in developing and transition economies grows faster than in developed countries (UNCTAD 2012).

In 2010 the Netherlands continued to be the country with most inward and outward FDI in the world (IMF 2012). However, DNB (2011) already noted that "only part of the total amount reflects foreign direct investment that affects the Dutch real economy". Special Purpose Entities (SPEs, see below) account for around 75 percent of the total of Dutch direct investment (DNB 2011), but they do not affect the Dutch real economy. Part of the remaining 25 percent is channelled through the Netherlands without any relation with the Dutch real economy either. Note that the Netherlands would be in the top ten of worldwide FDI even without the SPEs.

The information about foreign investments can be divided into two parts: foreign direct investments (FDI) and foreign affiliates statistics (FATS). FDI describes the financial flows to and from countries, the financial relations. FATS describe their effects on the real economy, the economic relations. However, there are important differences between FDI and FATS. For example, part of FDI is channelled through countries without having an effect on their real economies.

This chapter deals with both FDI and FATS. It starts with developments in Dutch FDI. In section 4.3 we focus on statistics that describe the activities of foreign controlled enterprises residing in the Netherlands and the activities of Dutch controlled enterprises in foreign countries. In section 4.4 we discuss the activities of Dutch controlled enterprises in foreign countries. These sections pay special attention to the BRIC countries: Brazil, Russia, India and China. In section 4.5 we present our conclusions and suggestions for further research.

4.2 Dutch Foreign Direct Investments

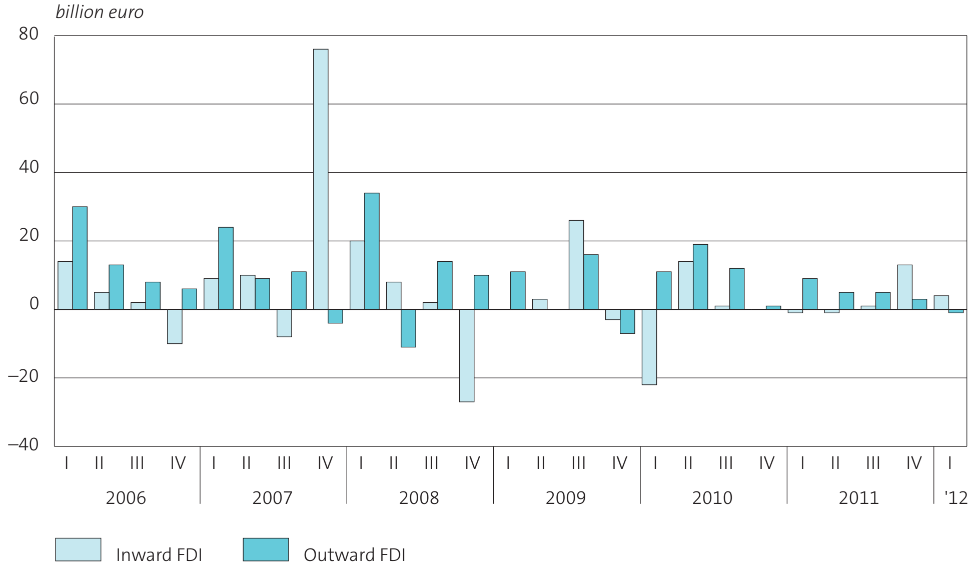
Definitions and methodology FDI

The leading authority on FDI in the Netherlands is De Nederlandsche Bank (DNB). It collects, compiles and publishes the data on incoming and outgoing FDI as a part of the Balance of Payments according to the IMF Balance of Payments Manual (IMF, 1993). DNB divides FDI into manufacturing (the sectors A-F in NACE Rev. 2, which includes for example mining and the metal industry) and services (the sectors G-S minus O, which includes for example trade and the financial sector). For inward and outward FDI, the economic sector is that part of the enterprise in the Netherlands that receives or makes investments.

Special Purpose Entities (SPEs). According to De Nederlandsche Bank, SPEs, sometimes also referred to as special financial institutions (SFIs), are Dutch-based subsidiaries of foreign parent companies that "function as financial turntables for foreign components of the group to which they belong. (...) With its favourable tax climate and infrastructure, the Netherlands has always been a popular domicile for SPEs." (DNB 2008–9, pages 195 and 7). De Nederlandsche Bank publishes detailed FDI statistics in two versions, one excluding and one including the SPEs.
For more definitions and methodology see the introduction of chapter 12.

Development of Dutch FDI flows and stocks

4.2.1 Quarterly Dutch FDI flows



Source: De Nederlandsche Bank.

Graph 4.2.1 shows that FDI flows fluctuated greatly in recent years, mostly due to one-off factors such as a major transaction. So the figures should be interpreted with caution. For example, inward FDI rose substantially in 2007, largely due to the takeover of ABN AMRO by foreign banks. But in the fourth quarter of 2008 it fell sharply because the Dutch government acquired the Dutch part of the Belgian Fortis company.

Whereas 2010 showed negative inward FDI flows because many countries disinvested, investments were the overall trend again in 2011 and in the first quarter of 2012. Dutch FDI follows the general trend in the European Union, with lower investments in 2010 but improvement in 2011 (Nowak 2012). Enterprises mainly from Germany and Switzerland invested in the Netherlands in 2011. The Netherlands has never attracted so many foreign investment projects within one year as in 2011 (Ernst & Young 2012, IBM 2012).

Outward FDI flows are still trailing a little behind, with lower levels than before the crisis began. But again, one-off factors cause the flows to fluctuate. The largest investments of Dutch enterprises were in the United Kingdom and in Switzerland.

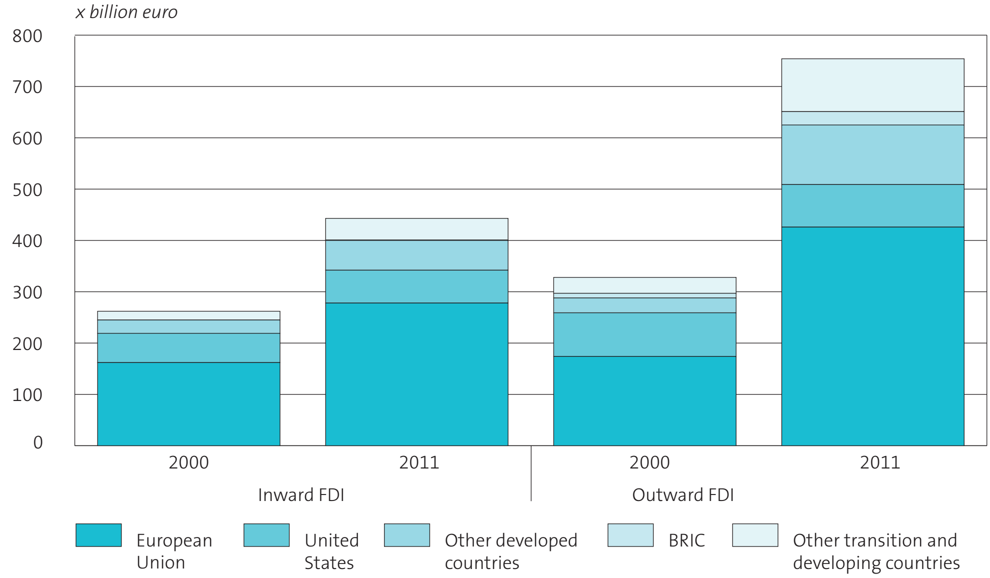
Investment worldwide shows growth and recovery. FDI was growing before the economic crisis of 2009, and then declined. This was mainly because international investors had less access to credit, which made investing more difficult. They withdrew funds from foreign markets to mitigate this and because they wanted to reduce exposure there (Nowak 2012). UNCTAD (2012) observed that FDI flows expanded in 2011 in developed[1)], transition and developing countries. The flows even surpassed the pre-crisis levels of 2004–2006. But the levels of inward and outward FDI have not yet returned to the peak values of 2007. UNCTAD expects continuous, albeit slower, growth in 2012. It reports that multinationals now have record holdings of cash, but that risks and uncertainties such as sovereign debts and the euro crisis are slowing down investments.

As far as the distribution of Dutch inward FDI among countries is concerned, developed countries have by far the largest amount. There was a major change in the distribution. The value of inward stocks from the United States only increased slightly between 2000 and 2011. That of other regions doubled. Investment from the BRIC countries grew in this period, amounting to 938 million euro in 2010.

Dutch outward FDI relates more often to developing countries than Dutch inward FDI. Also, FDI to developing countries is growing faster than to developed countries. For example, Dutch FDI in the BRIC countries tripled from 2000 to 2011 to a total value of 26 billion. At the same time Dutch FDI in the United States decreased.

1) UNCTAD discerns developed countries (the OECD members other than Chile, Mexico, the Republic of Korea and Turkey), plus the new European Union member states that are not OECD members (Bulgaria, Cyprus, Latvia, Lithuania, Malta and Romania), plus Andorra, bermuda, Liechtenstein, Monaco and San Marino), transition economies (South-East Europe and the Commonwealth of Independent States) and developing countries (the remaining countries).

4.2.2 Dutch inward and outward FDI stocks, by region of origin/destination



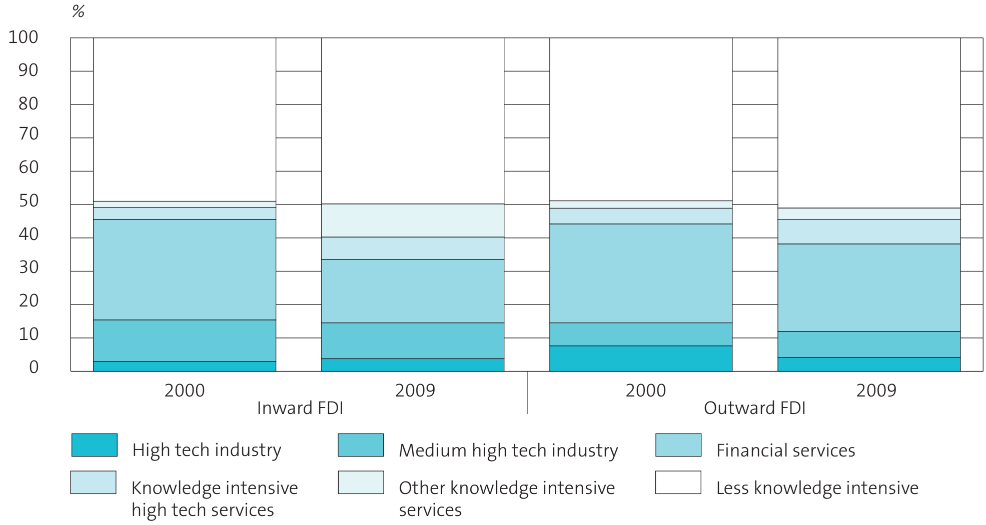
Source: De Nederlandsche Bank, calculated by Statistics Netherlands.

More detailed information about inward and outward FDI on country level can be found in chapter 12 “Foreign direct investments” of this edition.

The knowledge intensity of Dutch FDI

We now turn to the knowledge intensity of FDI, following Weterings et al. (2011). They used a classification of Eurostat (2009) that assigns a knowledge intensity to every economic sector. Graph 4.2.3 shows that about half of inward FDI is in the knowledge intensive sector. It contains the high tech industry, the medium high tech industry, financial services, knowledge intensive high tech services and other knowledge intensive services such as publishing activities. The other half consists of less knowledge intensive sectors such as the food industry or the production of furniture. During 2000–2009, the share of FDI stocks in knowledge intensive sectors remained the same. The share of financial services declined, because FDI in this sector remained the same while it grew in other sectors. But the share of other knowledge intensive services, such as business and management consultancy, increased.

4.2.3 Inward and outward FDI, by knowledge intensity of economic sector [1]



[1] Due to a break in the classification of economic activities (NACE Rev. 1.1 to NACE Rev. 2) it was not possible to compare 2000 with 2010.

Source: De Nederlandsche Bank, calculated by Statistics Netherlands.

Half of Inward FDI is knowledge intensive

Of course there is much heterogeneity in the investments of countries. Lejour and Lemmers (2012) point out that investments from the United States and Japan are on average much more knowledge intensive than those from Europe. The United States are specialised more in knowledge intensive financial services and Japan more in medium high tech industry, especially the chemical industry. European countries are far less represented in high tech and medium high tech industry, but they are more diverse than FDI from the United States or Japan. Only one fifth of the incoming FDI from the BRIC countries, about 1 billion worth, was in knowledge intensive sectors.

There were no major shifts in knowledge intensity for outward FDI. The share of high tech industry and financial services declined somewhat, but that of other knowledge intensive services grew. The distribution of knowledge intensive/extensive was about fifty-fifty, just like for inward FDI. The knowledge intensity of outward Dutch FDI is not the same in each country. For example, Dutch FDI in the United States is more knowledge intensive than average, because about half of the investments are by the knowledge intensive financial sector. On the other hand, Dutch investments in the BRIC countries are less knowledge intensive. Here the major Dutch investors are involved in manufacturing food and beverages, or in manufacturing coke and refined petroleum products. Eurostat has classified these activities as less knowledge intensive.

More detailed information about FDI stocks broken down by economic sector can be found in chapter 12 “Foreign direct investments” of this publication.

As mentioned in the text box, FDI measures financial cross border flows, but some might only be channelled through the Netherlands without having a sizeable effect on the real economy. This is confirmed by UNCTAD (2012), which introduces an FDI contribution index in the World Investment Report 2012. It ranks economies on the basis of the significance of FDI and foreign affiliates in their economy, in terms of value added, employment, R&D and so on. UNCTAD also publishes an FDI attraction index, which measures the success of economies in attracting FDI. The score of the Netherlands on the FDI contribution index is lower than that on the FDI attraction index. UNCTAD suggests that this might have to do with favourable fiscal or corporate governance regimes in the Netherlands.

It would be great to capture the real contribution of FDI to the Dutch economy and that of Dutch FDI to foreign economies. That is, after deducting funds which transit the country without having any durable economic impact. DNB (2008) already made concrete proposals to do so. And the OECD (2011) works to achieve this goal by integrating financial (FDI) and economic (FATS) measures. This would show the real interdependency between countries as far as investment flows are concerned.

4.3 Foreign controlled enterprises in the Netherlands

Table 4.3.1 describes the activities of enterprises that reside in the Netherlands and have a foreign Ultimate Controlling Institutional Unit (UCI). In this context, enterprise A is deemed to be controlled by an institutional unit B when B controls, directly or indirectly, more than half of the shareholders’ voting power or more than half of the shares. These statistics are part of the Inward Foreign Affiliate Statistics (inward FATS).

4.3.1 Share of foreign controlled enterprises in total private Dutch sector (excluding financial sector)

	2001	2002	2003	2004	2005	2006[1]	2007	2008[1]	2009	2010
	%									
Number of enterprises	0.7	0.8	0.7	0.7	1.2	1.1	1.0	1.0	1.0	1.0
Number of persons employed	11.9	13.5	12.9	14.0	14.5	13.9	13.4	14.0	15.5	15.1
Turnover	23.7	25.1	25.3	27.1	26.7	29.9	29.4	31.4	32.4	34.1
Value added at factor costs	17.5	20.5	19.2	20.9	20.5	23.4	22.3	24.4	24.4	25.7
Gross fixed capital formation	16.9	19.2	15.4	17.6	17.8	20.0	20.6	21.8	22.8	24.2

Source: Statistics Netherlands, Inward FATS.

[1] Between 2005 and 2006, 2007 and 2008, there are breaks in the time series due to changes in the definitions.

Foreign controlled enterprises steadily increase their share in the Dutch private sector, even though there are relatively few of them. In 2010, they generated more a quarter of the value added in the private sector, which amounts to 14.6 percent of GDP against factor costs. Furthermore, they employed around 804 thousand people. And foreign controlled enterprises accounted for almost a quarter of private sector investments. In general, these enterprises are larger than Dutch controlled enterprises, they are more productive (Fortanier and Van de Ven, 2009), they pay higher wages (Fortanier and Korvorst, 2009) and they are more often involved in international trade (Jaarsma and Lemmens-Dirix, 2011). This is observed for different countries. Theory suggests (Melitz 2003, Helpman et al. 2004) that the underlying cause is the higher productivity of foreign controlled enterprises.

Methodology inward FATS, differences FATS and FDI

The foreign affiliate statistics (FATS) present detailed data on the activities of foreign affiliates, e.g. employment levels, turnover and value added. The inward FATS cover the private sector excluding the financial sector, the outward FATS cover the whole private sector. Detailed information on the level of country and economic sector can be found on StatLine, the free online database of Statistics Netherlands.

FATS data only concern a sub-set of the entities involved in FDI. Inward FATS only consider enterprises that are controlled by a foreign enterprise with over 50 percent of the voting power, whereas inward FDI considers enterprises where a foreign enterprise has 10 percent or more of the voting power. Therefore there are fewer enterprises engaged in Inward FATS than in inward FDI, generating less employment, value added and so on.

Another important difference between FATS and FDI statistics is that FATS use the concept of ultimate controlling institute (UCI), whereas FDI uses the concept of direct investor. For example, suppose a Dutch enterprise controls a German enterprise, which in turn controls a second Dutch enterprise. Then the UCI of the second Dutch enterprise is Dutch, hence it is not counted in the FATS. However, the direct investor is German so it is counted in the FDI.

See the IMF Balance of Payments Manual and the FATS Regulation for other methodological differences.

Turnover of foreign controlled enterprises is mainly generated in manufacturing and trade. These two sectors account for three quarters of total turnover by foreign controlled enterprises. Bruls and Leufkens (2011) already pointed out that the share of these enterprises differs greatly by sector. For example, 58 percent of turnover in the sector production and distribution of water, gas and electricity is created by foreign controlled enterprises, but only 2 percent in the sector real estate. This share is also high for manufacturing, but small for building and construction.

The United States, Germany, France and the United Kingdom are the main controlling countries (UCIs) of the enterprises. Together they have a 23 percent share in total turnover by the private sector or 67 percent share of the total turnover by foreign controlled enterprises. The share of the BRIC countries in the private sector is still very small, about 3 pro mille.

There can be many different reasons to invest in the Netherlands. Interviewed decision makers of foreign enterprises (Ernst & Young, 2012) remarked that they are very satisfied with the presence of high-grade knowledge and technology, stable social environment, favourable tax climate, good infrastructure and highly educated employees. They are less satisfied with cost of labour and real estate. Furthermore, labour laws concerning hiring and firing are considered unfavourably by many investors.

Depending on their ultimate controlling institute (UCI), foreign controlled enterprises in the Netherlands have noticeable differences in productivity levels. These differences are partly caused by a composition effect. For example, Dutch enterprises with French UCI have relatively more employment in trade and storage, with a lower productivity level. But the enterprises that are controlled by the United States have relatively much employment in manufacturing, with a higher productivity level. Fortanier and Moons (2011) took such heterogeneous factors at the enterprise level into account. They found that enterprises controlled by the United States and Japan have high productivity levels. Their explanation is that these countries have much experience with internationalisation and that they are at the technological frontier. They also found that enterprises controlled by China are less productive. As possible causes they suggest less experience with international expansion and a different investment strategy, namely not seeking productivity but technologies and knowledge. However, the low share of Chinese FDI in knowledge intensive Dutch sectors suggests that this last explanation does not hold.

4.4 Dutch controlled enterprises outside the European Union

This paragraph will address the following questions about presence of Dutch controlled enterprises outside the EU:

- What are the main activities of these enterprises?
- In which countries are they located?
- How does the size of these activities compare to that of other countries?

It is the first time that statistics of these enterprises are described in more detail. The name of these statistics is Outward Foreign Affiliate Statistics (Outward FATS).

Methodology Outward FATS

Statistics about the activities of Dutch controlled enterprises abroad are limited. They are available only for Dutch daughter enterprises in countries outside the European Union. Data collection for the Outward FATS started for reporting year 2007, and only for the variables sector of activity, number of enterprises, turnover and number of employees. It is theoretically possible to construct the same statistics about the presence of Dutch controlled enterprises in EU countries by using the statistics of other countries about activities in their country. However, such data are often confidential because so few enterprises are involved.

Detailed information on the country and economic sector level can be found on StatLine, the free online database of Statistics Netherlands.

4.4.1 Key figures on the presence of Dutch controlled enterprises outside the EU

	Unit	2008	2009	2010
Daughter enterprises		6,125	8,055	8,225
Employees	*x 1,000 fte*	784	761	796
Turnover	*billion euro*	493	363	485

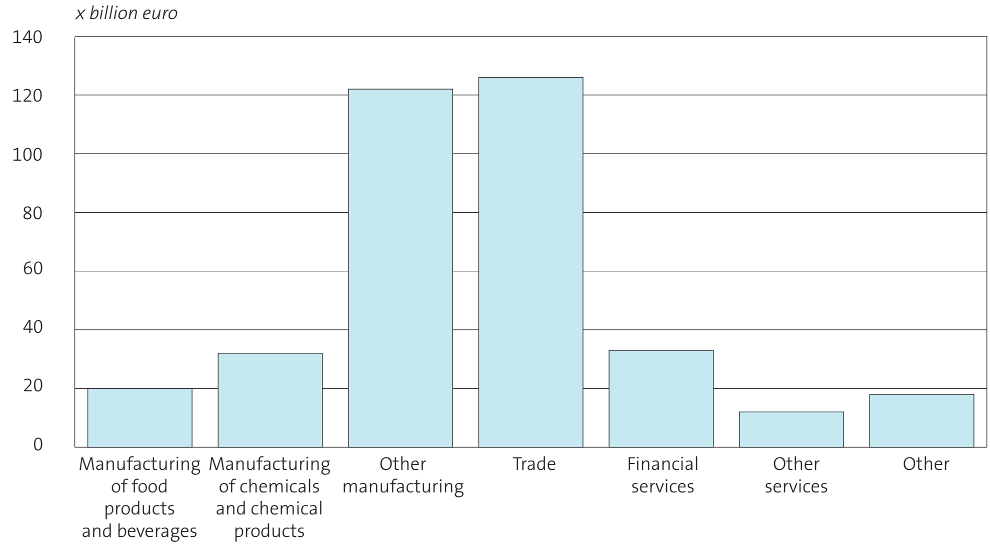
Source: Statistics Netherlands, Outward FATS.

The economic crisis greatly affected the turnover of Dutch controlled enterprises outside the European Union. Between 2008 and 2009 it fell by more than a quarter. It fell across the board in almost all subsectors of manufacturing and services. This turnover recovered in 2010 to return to the level of two years earlier. The number of employees did not decrease much in 2009, suggesting that enterprises chose to keep their personnel employed. This labour hoarding took place in the Netherlands as well. The Dutch Bureau for Economic Policy Analysis (CPB) wrote that it is expensive to fire employees and that

Dutch enterprises were afraid it would be difficult to hire qualified personnel again after a quick recovery of the economy (De Jong, 2011). Despite the economic downturn, the number of Dutch controlled enterprises increased substantially, which may indicate that Dutch enterprises still see opportunities abroad.

Activities of the daughter enterprises in the economic sectors abroad are evenly spread among manufacturing and services. In 2009, about 35 percent of turnover was realised in trading. However, it is important to realise that the value added of trade is less than that of other services activities or manufacturing. Chemicals and financial services were the other major active sectors, with a turnover of about 30 billion euro, about ten percent of total turnover.

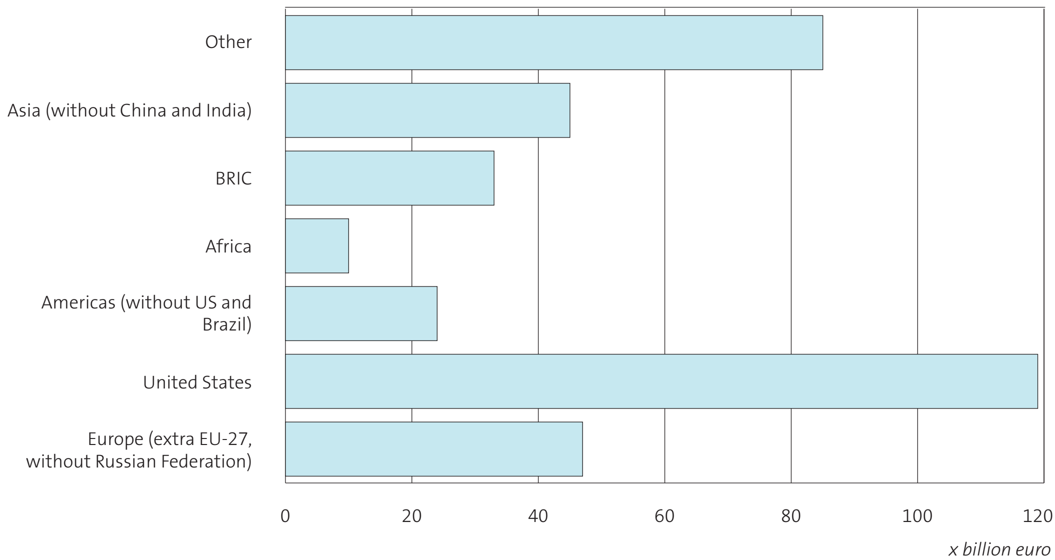
4.4.2 Turnover Dutch controlled enterprises outside EU, by economic sector, 2009



Source: Statistics Netherlands, Outward FATS.

In 2009 Dutch controlled enterprises generated the highest turnover in the United States. They had a joint turnover of 119 billion, which is almost a third of total turnover created by Dutch controlled firms active outside the EU. Dutch daughter enterprises active in BRIC countries had a 9 percent share in total turnover. This is still less than that of European countries (EU and Russia excluded), but more than in countries on the American continent (United States and Brazil excluded). However, the share of the BRIC countries is increasing. Not because turnover in these countries is increasing, but because turnover decreased less than in the other non-EU countries. Turnover in China was not greatly affected by the economic downturn.

4.4.3 Turnover of Dutch controlled enterprises outside the EU, 2009



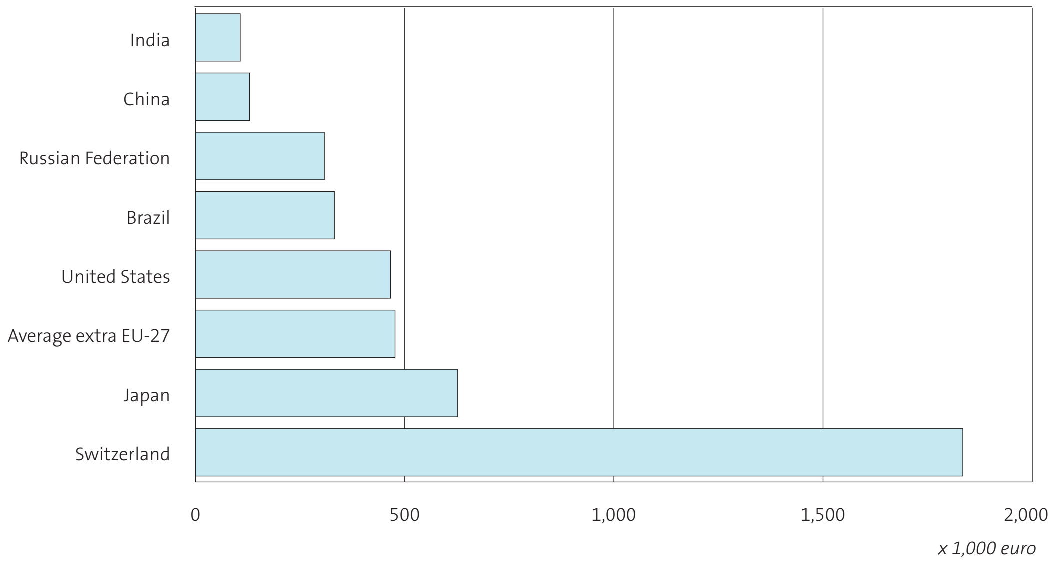
Source: Statistics Netherlands, Outward FATS.

Dutch enterprises have daughter enterprises in highly developed as well as in developing countries. This is not surprising, because enterprises have other reasons besides seeking cost efficiency though lower wages when they transfer activities abroad. In a survey conducted by Statistics Netherlands in 2008 (Van Gessel-Dabekaussen et al.), enterprises indicated that following clients and rivals, access to specialised knowledge, access to new markets and an improvement of logistics also played major roles in their decision to venture abroad.

There are large differences in terms of turnover per employee by country of destination. This is reflected by graph 4.4.4, that shows the average turnover per employee for several host countries. The average turnover per employee is 477 thousand euro, but an employee at a Dutch controlled enterprise in Switzerland generates about four times as much turnover. Many work in the Swiss services sector, especially financial services, which generally creates more turnover than manufacturing. On the other hand, the average employee at a Dutch controlled enterprise in China or India works in manufacturing where the general price level is far lower, explaining the below average turnover per employee.

Dutch controlled enterprises are very active outside the European Union

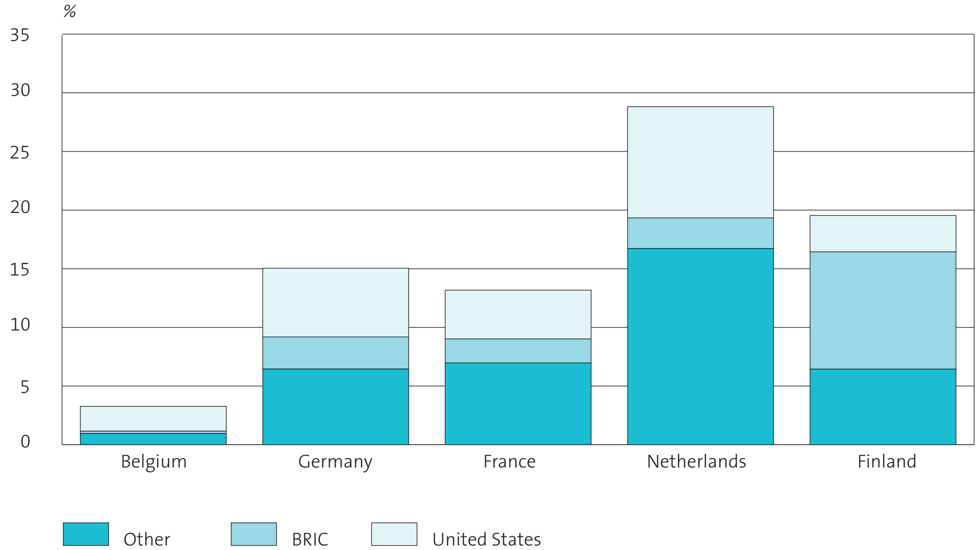
4.4.4 Average turnover per employee at Dutch controlled enterprises outside the EU, by country, 2009



Source: Statistics Netherlands, Outward FATS.

The Dutch economy is very internationally oriented as far as trade and FDI are concerned. The Netherlands is the fifth exporter of goods in the world (WTO 2012) and is in the top ten for FDI even after correction for the SPEs (DNB 2011). The Netherlands is also very internationally oriented when it comes to turnover of Dutch controlled enterprises outside the EU. Graph 4.4.5 shows that turnover generated by Dutch controlled enterprises outside the EU equals almost 30 percent of turnover of all enterprises in the Netherlands. The graph also shows that the Netherlands generates twice as much turnover outside the EU than Germany and France, and almost nine times as much as Belgium, relatively speaking. To correct for the different sizes of the economies, the ratio of turnover outside the EU is divided by the turnover in the business economy of the country itself.

4.4.5 Ratio of turnover outside the European Union and national turnover, 2009



Source: Eurostat, calculated by Statistics Netherlands.

The graph suggests that Dutch enterprises use the possibilities of producing and selling in emerging markets just as well as German and French enterprises. Different sources (OECD 2012, Groot et al. 2011a, Groot et al. 2011b) noted that this might be different for exports and FDI. Dutch enterprises export and invest relatively less in the BRIC countries than enterprises from other countries. This has led to concerns that Dutch enterprises do not seize the opportunities in emerging markets as much as other countries, leading to less GDP growth and less of a competitive edge. For example, OECD (2012) wrote that "However, a concern is that exports of domestically produced goods remain focused on slow-growing traditional European markets and not sufficiently on emerging countries."

Turnover in the BRIC countries is far higher for Finnish than for Dutch, German and French controlled enterprises. Half of this turnover is in the sector radio, television and communication equipments" probably related to the strong Finnish mobile phone industry. But Finnish controlled enterprises also generated substantial turnover in the sectors business and management consultancy, wholesale, and trade and repairs.

Still, graph 4.4.5 does not paint a complete picture. First of all, the composition of the population of foreign controlled enterprises differs by country. For example, if a country has relatively more daughter enterprises in the manufacturing sector of developing countries, these enterprises will generate less turnover than daughter enterprises active in high level services in developed countries. Another explanation is that distribution of daughter enterprises among countries may differ: Belgian controlled enterprises may be more concentrated inside the EU (not shown) than outside the EU (shown in graph 4.4.5).

4.5 Conclusions and further research

Whereas Dutch inward FDI in 2010 and the beginning of 2011 was affected by the economic crisis, it showed signs of recovery in the second half of 2011 and the beginning of 2012. Similar trends can be observed in other EU countries. Dutch outward FDI, however, is still trailing a little behind. Knowledge intensity of inward FDI did not change much between 2000 and 2009, whereas that of outward FDI decreased slightly during the same time period.

The share of foreign controlled enterprises in the Dutch economy continues to grow. Dutch controlled enterprises outside the EU were severely affected by the economic crisis in 2009 and had much less turnover than the year before. However, it recovered during the next year and returned to the level before the crisis. This turnover outside the EU27 as a share of domestically generated turnover was higher than that of enterprises controlled by other countries. Turnover of Dutch affiliates in the BRIC countries was much higher than that of Belgian controlled enterprises in these countries, but similar to that of German or French controlled enterprises.

Further research is necessary to divide FDI into two parts: the amount that is really invested in the Netherlands and the part that passes through the country without having any durable economic impact. This would add an extra dimension to the currently available numbers, namely that of the interdependency between countries. DNB (2008) has already described how to achieve this goal.