

Foreign direct investment in Spain

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Since the mid-2000s, Spain has played an important role both as a destination for and source of foreign investment. Strengthening FDI from abroad will help Spain continue to reap the benefits for the Spanish economy, while the country aspires to increase expansion in new and existing markets.

Globalization has helped accelerate the growth of FDI, allowing it to become one of the key factors of the global economy. Developed countries, and the EU in particular, have always been the leading players in FDI, although developing countries are assuming an ever-increasing role. In the case of Spain, since the mid-2000s, the country has become not only an important destination for FDI, but also a source, making Spain today Europe's 3rd economy for outward FDI as a share of GDP and second for inward FDI. Most of Spain's inward FDI has been channeled into the services sector with outward FDI mainly driven by large, productive companies. As regards geographic distribution, Europe and the U.S. (albeit to a lesser degree) continue to be main investors in Spain, even though developing countries are increasing penetration. Most outward investment is destined towards Europe and Latin America. Foreign investment in Spain, as well as Spanish investment abroad, has proven to be profitable, with positive spillover effects in terms of GDP growth, employment, exports, and efficiency gains for Spanish firms. Investment abroad by Spanish companies has also been beneficial, often accompanied by greater investment in human capital and R&D. Taking these factors into consideration, policy should aim to attract more FDI into Spain, while fostering the continued outward expansion and diversification of Spanish foreign investment.

Introduction

This article examines Spain's foreign direct investment (FDI) position, analysing its evolution, characteristics, determinants, and impact on the Spanish economy by looking at both Spain's inward and outward foreign direct investments. Investment from abroad can be described as the development in Spain of branches of multinational

enterprises owned by non-residents, while Spain's foreign investments can be seen in the investment activity abroad of Spanish-based companies, most of which are multinationals owned by Spanish residents. However, subsidiaries of foreign multinationals also invest abroad from within Spain, such that there is a strong and interesting relationship between these two facets of investment.²

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² The analysis in this article summarises the content of a more extensive study recently published (Myro 2014) on this topic that was carried out by a large group of specialists sponsored by the Spanish Institute for Foreign Trade (ICEX). This study sought to show how Spain had been performing in terms of foreign direct investment, assess its significance for the Spanish economy, detect any potential for it to be increased, and guide FDI-promotion policies.

The analysis in this article is based on the foreign direct investment position (FDIP) variable, which is a measure of the stock of FDI, calculated as the sum of the equity of subsidiaries owned by multinational enterprises, and the finance they receive from the business group to which they belong. Although the data are less up-to-date, the analysis is more precise and reliable than that based on annual FDI flows, which are highly volatile and very sensitive to both the economic situation and financial constraints. Moreover, there are two main sources that can be used to obtain FDIP data: the balance of payments, which allows international comparisons to be made (prepared by organisations such as UNCTAD, the OECD, etc.) and the register of foreign investments, which provides more complete and reliable data, but which is limited to companies located in Spain. A comparison of these two sources reveals similar trends, but the values given by the balance of payments are always higher, although it is not easy to explain why, particularly in the case of inward investment, where the discrepancy is greatest.

A brief overview of global FDI

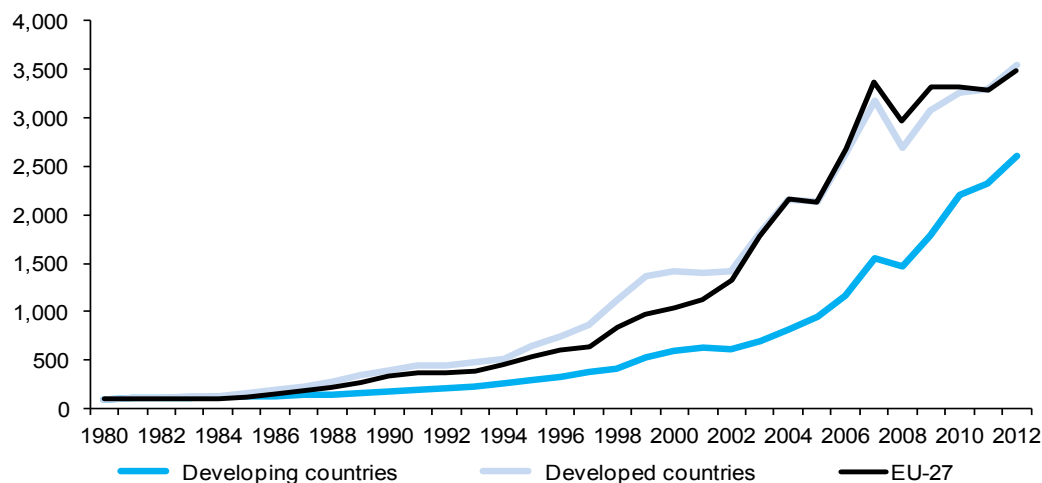
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the 1980s, it has grown at average annual rates that far exceed those of output and world trade. This rapid growth was barely affected by each recession and crisis until the present one, which conversely has had a substantial impact (Exhibit 1). Nevertheless, it has not halted FDI's progress, such that 2012's figures still exceeded those of 2007.

Exhibit 1

Change in stock of inward FDI, 1980-2012 (1980=100)



Note: Value in US dollars at current prices and exchange rates.

Sources: UNCTAD, UNCTADSTAT.

Within this solid growth trend, the decade of the 2000s stands out during the period, as the stock of FDI multiplied slightly more than threefold, accounting for a large share of the increase seen over the three decades looked at here. However, the start of the acceleration in the growth rate did not coincide exactly with the start of the decade, beginning slightly earlier at the end of the 1990s.

The main players in FDI have always been the developed countries, with the European Union in particular being a major receiver and issuer of FDI flows. However, since the mid-2000s, and particularly since 2007, coinciding with the current economic crisis, developing countries began to move up the rankings consistently, having obtained a third of the world's total direct investment in 2012, ten percentage points more than in 2005.

The change in the relative positions of the two groups of countries was in reality even more profound, as multinational enterprises originating in developing countries, led by China, have emerged forcefully onto the international stage as major investors. This fact has also changed the composition of outward FDI. The proportion of total FDI that corresponds to the developing countries was barely perceptible in 1990 (7%), and remained low in 2005 (12%), but is now close to 20%. The new multinationals, as the emerging market multinational enterprises are

sometimes termed, have different characteristics from traditional ones, posing fresh challenges for the already complex analysis of multinational enterprises (Guillén and García-Canal, 2011).

Corporate mergers and acquisitions have always played an important role in this process of FDI expansion, with a value equal to over three quarters of total flows. But in the years before the crisis, they started to lose ground to greenfield investments, despite the prevalence of large operations ("megamergers"), and have fallen dramatically in subsequent years.

There are many factors behind this formidable expansion in FDI, but it is difficult to assess them individually. However, rising globalisation and its effects undoubtedly play a central role, as suggested by theoretical models (Helpman, 2011).

Spain and the expansion of FDI

Spain has played an important role in this expansion of FDI. First, as a significant destination for inward foreign investment, and later, particularly in the mid-2000s, as an important source of FDI. As Table 1 shows, investments from abroad began their rapid ascent around 1990, when they accounted for 3.2% of the world total, a percentage that declined shortly after as a result of the considerable expansion in international flows, but recovered in 2007. On the other hand,

Table 1

Spain's share of global FDI, 1980-2012 (Percentages)

	Inward FDI						Outward FDI					
	1980	1985	1990	2000	2007	2013	1980	1985	1990	2000	2007	2013
Spain/ World	0.7	0.9	3.2	2.1	3.2	2.8*	0.4	0.6	0.7	1.6	3.0	2.7*
Spain/ EU-27	--	--	8.7	6.7	7.8	8.5**	--	--	1.9	3.7	6.7	6.3**
Spain/ EU-15	2.3	3.8	8.7	7.0	8.5	9.0**	0.9	1.5	1.9	3.7	6.7	6.2**

Note: (*)2012. (**)OECD.

Sources: UNCTAD, World Investment Report and UNCTADSTAT, and OECD.

Spanish firms' investments abroad progressed more slowly from their beginnings in the 1960s, but accelerated rapidly in the 2000s, rising to 3% of global investment in 2007.

Thus, during the 2000s, Spain advanced substantially along the path followed by the more advanced economies, going from being a net recipient of investments –the position in which it remained until the start of the 1990s– to being a significant foreign investor, with a stock of capital from foreign multinationals in the country equal to that of Spanish multinationals abroad, currently around 2.8% of GDP. This is an appreciably higher share than that of global output (1.6%) or global trade (1.8%). Likewise, Spain went from being a net seller of businesses to non-residents to a leading buyer between 2004 and 2006, accounting for 38% of European cross-border acquisitions.

Spanish firms' sharp upward path in foreign investment, now involving 2,500 firms with 4,500 subsidiaries, can be seen more clearly in Exhibit 2,

which shows the change in investment measured relative to GDP, as an indicator of investment intensity. In 1990, Spain's value on this indicator was below that of the other four EU economies, but it soon overtook Italy, and then Germany as the crisis began. Today it is Europe's third

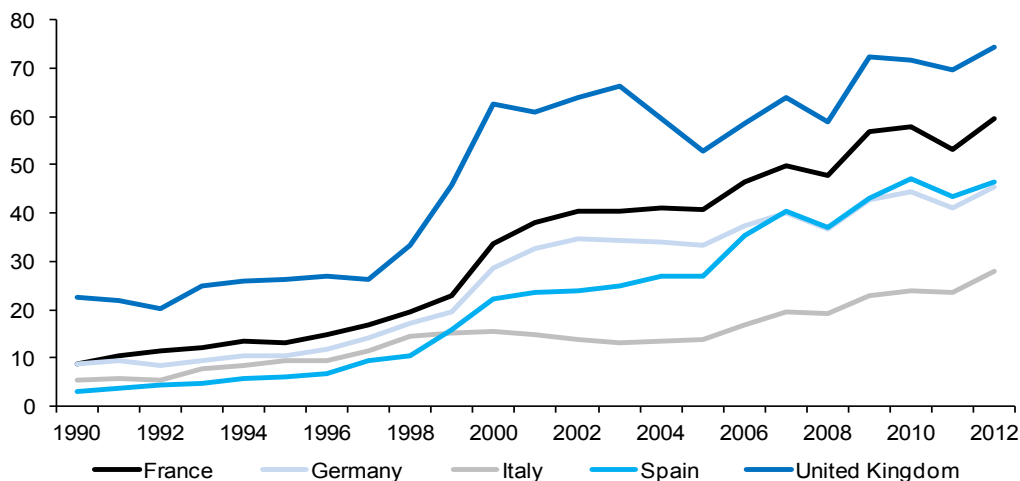
Today, Spain is Europe's third economy for outward FDI as a share of GDP and second for inward FDI.

economy for outward FDI as a share of GDP and second for inward FDI. It can aspire to follow in the footsteps of the United Kingdom and France, which are both net sources of FDI and important destinations for inward FDI. Germany is a net issuer because its level of inward FDI relative to GDP is fairly low.

The current crisis has caused Spain to drop down the rankings of world FDI, but this has not affected the volume of both types of financial

Exhibit 2

Outward FDI intensity of main European Union countries, 1990-2012
(FDI stock as a percentage of GDP)



Note: Data for France, OECD.

Sources: UNCTAD, World Investment Report and OECD.

stocks, i.e. investments received and those sent abroad, which have grown faster even than in other European countries. This apparent paradox is explained by the fact that, as discussed, all the developed countries have seen a negative impact on their shares of global investment as a result of the ascent of the developing countries, not only as destinations of FDI but as active sources of foreign investment, through a wide range of new multinationals.

Determinants and sector orientation of FDI

There are currently more than 9,000 subsidiaries of foreign multinationals in Spain, counting direct and indirect holdings (over 4,000 are owned directly), and their average size is large in comparison with those in the main European economies. Existing empirical studies suggest that access to the large and rapidly expanding Spanish market was the main factor leading to subsidiaries being set up, particularly in the services sector, in activities in which less domestic capital was invested, and in businesses highly dependent on imports, such as medium-high (motor vehicles, metal working and chemicals) and high technology manufacturing (ICT manufacturing and pharmaceuticals). Foreign subsidiaries also gained importance in sectors such as foods, drink and tobacco, and non-metallic mineral products, where they complement an extensive productive fabric built with domestic

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made Spain significantly more attractive as a location for multinationals, by ensuring more open and competitive policies in greater harmony with those of its EU partners. Macroeconomic stability and balanced growth are two more major incentives.

From this, it may be inferred that the economic recovery and more balanced growth, based on a more flexible economy with more competitive markets, less red tape for businesses and strong backing for innovation and human capital, are the keys to encouraging inward FDI.

Spain's investments abroad have been led by large, highly productive companies that have been able to meet the cost of establishing themselves in their target markets and substitute a share of the exports destined for them advantageously, while encouraging other exports. Companies investing abroad report 18% higher productivity than those that do not, regardless of their size or business sector.

By expanding abroad, these companies have also sought to bolster their economies of scale and maximise the profitability of their intangible assets, primarily in countries that are geographically and culturally close and have strong growth potential, such as Spain's northern neighbours and in Latin America. This is a process that has advanced in parallel with expanding exports, and there is a robust statistical relationship between their exports and foreign investments.

These companies are today numerous (2,500), with over 4,550 foreign subsidiaries, the most significant among them having 200 or more employees and an average of 5.7 foreign branches. Their investments have followed a sector pattern similar to that of companies in larger EU countries, with the lion's share in services, particularly financial intermediation, telecommunications and energy. In manufacturing, the scale of investments by subsidiaries of foreign multinationals is overwhelming, accounting for 70% of the total, with investments in non-metallic mineral

products, metal working, chemicals, food, drink and tobacco, and motor vehicles and parts standing out.

Source and destination of investments

Europe is extremely important for both facets of Spain's FDI, but more so in terms of inward FDI than investments abroad. The U.S. is also one of Spain's main investors. More recently, Italy gained importance, its companies holding the largest stock of investments by volume in 2011, and there is growing penetration of developing economies, particularly Mexico, United Arab Emirates, Brazil, Israel, and Argentina, joined by Portugal.

As in the case of inward investment, outward FDI shows a clear specialisation in Europe. Nevertheless, Latin America also receives significant inflows. Investment in Latin America is explained by Spain's cultural and linguistic ties with the region, parallel to those of other countries with similar underlying reasons in other regions (the United Kingdom in North America, Asia and Africa). However, Spain rapidly scaled back its investments in Latin America in the early years of the century, continuing its path towards progressively broadening and diversifying its investments, as is the pattern in other developed countries, having received a significant boost from its integration with the European Union. Nevertheless, it has yet to achieve greater penetration in Asia, where other EU countries (with a negligible presence in Latin America) are more established.

Profitability

The implicit returns on investments by both foreign multinationals investing in Spain and Spanish firms investing abroad are in line with those of Germany, higher than those of France and Italy, but below those of the UK. During the crisis, returns diminished, but remained more than acceptable in the case of Spain's foreign

investments. The strong returns on investment are highly significant as they point to the existence of essential incentives necessary for it to continue. In particular, these returns confirm and strengthen the strategies of foreign and domestic multinationals, and the promise of continuity should facilitate rising investment activity in the coming years.

More specifically, the economic results obtained by foreign multinationals reported via the Register of Foreign Investments have been considerable, and similar to those of their domestic competitors. In particular, during the period of expansion from 2003 to 2007, the return on equity was 14.2 percent in the last year of this period, although the crisis has reduced these figures considerably.

Returns on Spanish investments abroad grew rapidly between 2003 and 2007, reaching a peak of 17.1 percent, driven by the expansion of global GDP. As a result of the crisis, the situation changed radically in 2008 and 2009, with the figures being practically halved. However, its one-off impact stopped there, as in subsequent years, on an aggregate level, returns were not far short of the average during the period of expansion, benefiting from stronger growth in the developing economies, as Exhibit 3 shows.

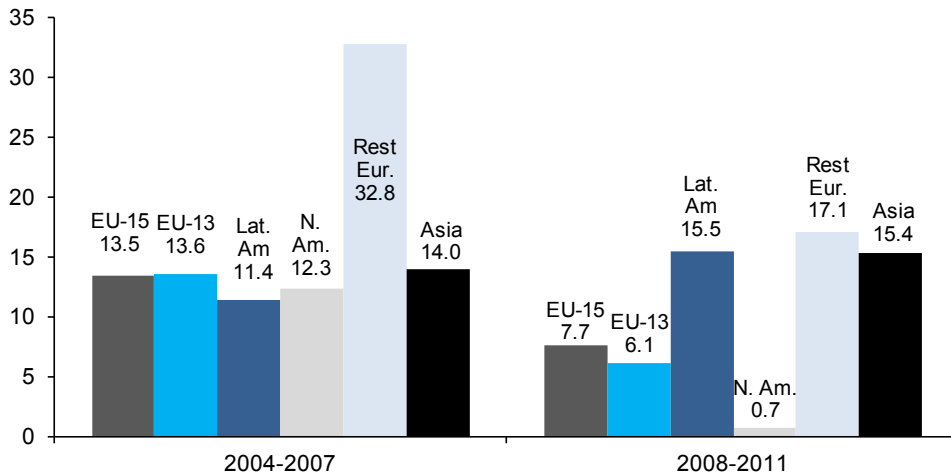
The returns Spanish firms earn abroad exceed those obtained domestically, whether by Spanish or foreign firms. They should therefore be interpreted as support for the strategy pursued by Spanish firms as regards their foreign investments,

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resulting in their becoming more competitive. It is also an expression of the fact that accessing rapidly growing markets has been a leading

Exhibit 3

Return on outward FDI stock by areas, 2004-2011 (Percentages)



Note: Return, previous year's earnings after tax/stock of FDI as a percentage.

Source: Register of Foreign Investments.

factor, as the studies on the determinants of this investment have concluded.

Effects on the Spanish economy

The existing studies show the activity of foreign multinationals' subsidiaries to have had a positive impact on the Spanish economy, promoting GDP growth, increasing employment and exports, and raising the efficiency of Spanish firms. The research on which this article is based assesses the effects of their investments in Spain between 2006 and 2013, using a computable general equilibrium model. This model estimated that they helped raise employment by 5.25%, cut the unemployment rate by 3.15 percentage points, and increased salaries in real terms by 1.89%, thus raising Spaniards' welfare by 2.79%. Separately, using a different methodology, the contribution of foreign subsidiaries to exports was estimated. This was found to be considerable (30 percent of the total), particularly in those sectors of manufacturing in which they have the

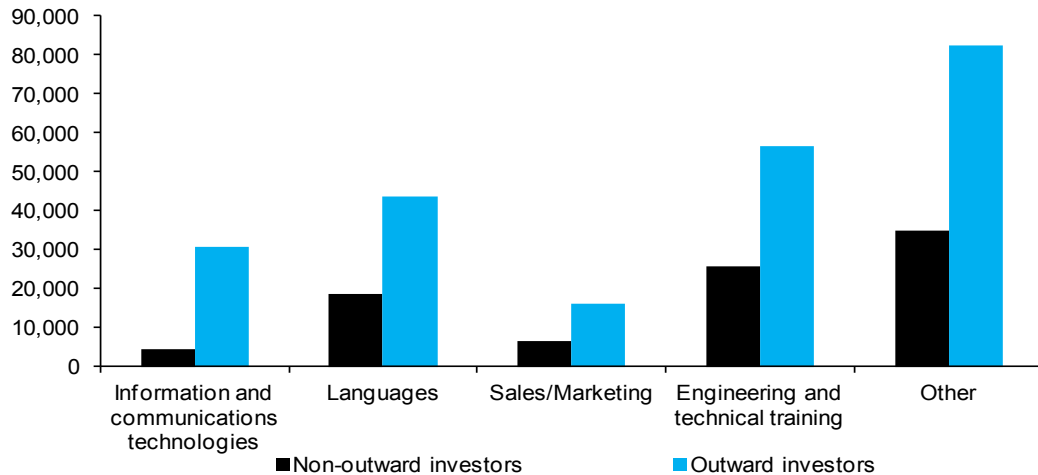
strongest presence and without a proportionate effect on imports.

The impact of investments abroad by Spanish-based companies was also strongly positive. Indeed, despite being basically *horizontal* investments, potentially substituting those made by the domestic market, the impact on employment seems to have been positive, according to the estimate included in our recent study. The impact on labour skills, technological effort, and exports also seems to have been positive for the companies involved. Although it has not been possible to analyse causality in the case of these three issues, there is strong evidence to suggest that they are much more significant in the case of companies with subsidiaries outside Spain. One of the most relevant indicators is that the number of employees devoted to R&D is six times that of companies that do not have subsidiaries elsewhere in the world.

This increased commitment to human and research capital must be what lies behind the

Exhibit 4

Average training expenditure of large Spanish firms (Euros)



Sources: SEPI Foundation, Business strategies survey.

higher productivity exhibited by companies investing abroad, which is also evident in terms of expenditure on training. Exhibit 4 shows these differences between industrial firms with over 200 employees. Our research estimated that investing abroad caused firms to increase their spending on training per employee by 15,000 euros a year. Moreover, there is little doubt that this human capital intensity is based on higher quality business management, which is a key competitive strength (Huertas & Salas, 2014).

Final considerations

The positive effects of FDI on the Spanish economy make it cost effective to strengthen the current highly regarded foreign investment promotion policy. This means endowing it with more resources and adopting the good practices of certain developed countries' more innovative FDI promotion offices.

Spain has achieved a high investment intensity ratio, i.e. ratio of the stock of inward investment to GDP, in attracting foreign investment. Raising it further is a major challenge for which an

ambitious approach is necessary. The United Kingdom's experience, with considerable FDI penetration in the manufacturing industry as well as in financial services, shows that it is possible to achieve this. Subsidiaries of Asian multinational are still relatively scarce on the ground in Spain and those from Latin America show an increasing trend. Investments in other countries still have considerable potential, and should aspire to hold the same percentages of investment intensity with respect to GDP as seen in France and the United Kingdom, and there is considerable scope for expansion in Asia, Africa and Latin America. Finally, companies with between 200 and 500 employees should be a target for investment promotion policy, as they present low and stagnating percentages of investment abroad.

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