

Foreign Direct Investment:

The Netherlands Distortion

Government statistics over-exaggerate the importance of the EU as a source of inward investment into the UK by sixty-six per cent

By Ian Milne

In the year 2000 alone, the earnings (receipts) on UK Foreign Direct Investment¹ ("FDI") overseas were £44 bn (almost three times the value of UK oil exports, almost five times the value of UK car exports; and 11 per cent of all UK exports). Earnings (payments) to overseas investors in the UK were £30 bn.

At the end of 2000 the net book value of all British FDI overseas was £605 bn, and the net book value of all FDI from overseas in the UK, £292 bn. FDI worldwide has grown rapidly in the 1990s and is now the main vector for global competition and trade development. The UK is the world's second-biggest outward investor (after the USA), and a main recipient of inward FDI. The USA and the UK are each other's principal FDI partners.

The UK's involvement in FDI - outwards and inwards - is thus of major importance for British prosperity. **Where do the vast flows of British outward investment go to? And where do the vast flows of inward investment come from?**

Official statistics² on the geographical distribution of British FDI flows give a hugely-distorted view of the real situation. The "official" picture **massively exaggerates (overstates) the importance of the EU**,³ both as a source of and as a destination for British FDI. At the same time, **the importance of the USA, and of - for example - South-East Asia**, as a source of

For Inward Investment in the UK:

The EU share of all earnings in the UK from FDI is overstated by 66 per cent.

The Dutch share of all earnings in the UK from FDI is overstated 19-fold

The US share of all earnings in the UK from FDI is understated by 19 per cent.

The Rest of the World (excluding the EU & the USA) share of all earnings in the UK from FDI is understated by 63 per cent.

As a Destination for UK FDI Overseas:

The EU share of the UK's worldwide earnings from overseas investment is overstated by 47 per cent

The Dutch share of the UK's worldwide earnings from overseas investment is overstated 14-fold

The US share of the UK's worldwide earnings from overseas investment is understated by 13 per cent

The Rest of the World (excluding the EU & the USA) share of the UK's worldwide earnings from overseas investment is understated by 17 per cent

and destination for British FDI, **is seriously understated.**

The cause is the Netherlands Distortion⁵. Once the official data is adjusted to compensate, it becomes clear that:-

References

1. FDI is long-term illiquid cross-border commercial & industrial investment by a business based in one country in a business based in another country, where the investor exercises control or significant influence. FDI occurs as "greenfield" investment, where the investor builds a facility from scratch; or, much more frequently, as the acquisition of an already-existing business.
2. Foreign Direct Investment 2000: Business Monitor MA4: February 2002: ONS.
3. "EU": the EU "14" comprising the 13 Continental members plus Eire.
4. "Earnings": aggregated (cumulative) earnings 1991-2000 inclusive.

5. The Netherlands Distortion

For tax reasons, FDI is often channelled through intermediate holding companies domiciled in the Netherlands. In collecting statistics on FDI involving the UK, the Office for National Statistics ("ONS"), as it is obliged to do by international conventions, records such FDI as originating in or going to the Netherlands, rather than the country of origin or the country which is the end-destination of the FDI. The resulting Netherlands Distortion affects geographical analyses not just of FDI flows, but of the income or earnings (in the form of dividends, interest & management fees) associated with them.

The unadjusted ONS statistics appear to show that the Netherlands, with just 5 per cent of the population and just 6 per cent of the GDP of EU "14", has supplied inward FDI into the UK accounting for 51 per cent of all EU "14" FDI earnings in the UK.

For UK outward FDI overseas the unadjusted ONS data appears to show that the Netherlands accounted for 42 per cent of the total earnings arising from UK FDI in the whole of the EU "14".

It is highly implausible, to say the least, that the unadjusted ONS data reflects the real levels of British FDI into and out of the Netherlands.

The Adjustment

It is assumed that the underlying "real" level of Dutch FDI in the UK, and of British FDI in the Netherlands, is the same per capita of the Dutch population as the recorded levels of inward and outward EU "13" (that is, EU "14" less the Netherlands) FDI per capita of the EU "13" population. The resulting over-recordings in respect of the Netherlands are then apportioned to other countries inside and outside the EU "13" pro-rata to their recorded shares of total inward and outward FDI in respect of the UK. (Similar results are given if GDPs are used instead of population.)

Ten-year aggregates of earnings are chosen so as to eliminate short-term, transient and anomalous factors; and because earnings (rather than FDI flows in any one year) capture the earnings on all investments made in and by the UK since the 18th

century until now.

The Impact of the Distortion on the UK Balance of Payments Current Account

Table 3 shows that, on average over the ten years 1991-2000 inclusive:-
 The annual earnings attributed to EU inward investment in the UK have been OVERSTATED by £1.9bn. Annual earnings attributed to UK outward investment in the EU have been OVERSTATED by £2.6bn

Table 3: Cumulative Earnings 1991-2000 Inclusive

On INWARD Investment into the UK

Country/Region	Recorded by ONS, £ bn	%	"Real" After Adjustment for Netherlands Distortion, £ bn	%	Over (Under) Recording: Recorded less "Real" Average annual £ bn
EU "14"	48.6	41	29.2	25	1.9
USA	54.4	46	64.6	55	(1.0)
Rest of World	14.7	12	23.9	20	(0.9)
World	117.7	100	117.7	100	-
Netherlands	25.0	21	1.3	1	2.4

On UK OUTWARD Investment

Country/Region	Recorded by ONS, £ bn	%	"Real" After Adjustment for Netherlands Distortion, £ bn	%	Over (Under) Recording: Recorded less "Real" Average annual £ bn
EU "14"	80.0	32	54.3	22	2.6
USA	73.0	29	82.2	33	(0.9)
Rest of World	97.0	39	113.6	45	(1.7)
World	250.0	100	250.0	100	-
Netherlands	33.9	14	2.4	1	3.2

See also [Global Britain Briefing Note No 9](#), 30th June 2000, Foreign Direct Investment (available at www.globalbritain.org); and The Facts about Foreign Direct Investment, JP Occasional Paper No 5, November 1998.