

Foreign Direct Investment: The Netherlands Distortion:

(an updated version of Global Britain Briefing Note No 20 dated 31st July 2002)

*Government Statistics exaggerate the importance of the EU
as a source of investment into the UK by 75 per cent*

In 2002, the earnings (receipts) on UK Foreign Direct Investment¹ ("FDI") overseas were £52 billion (almost four times the value of UK oil exports, five times the value of UK car exports and 13 % of all UK "credits on current account"). Earnings (payments) to overseas investors in the UK were £17 billion.

At the end of 2002 the net book value of all British FDI overseas was £572 billion, and the net book value of all FDI from overseas in the UK, £353 billion. FDI worldwide, including that involving the UK, grew rapidly in the 1990s, then fell back in 2001 and 2002. The UK is the world's second-biggest outward investor, after the USA, and the third-biggest recipient of FDI, after the USA and "China-plus-Hong-Kong". The USA and the UK are each other's principal FDI partners.

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 EU³, both as a source of and as a destination for British FDI. At the same time, the importance of the USA, and other parts of the world, as a source of and destination for British FDI, is correspondingly understated.

The cause is the Netherlands Distortion.⁵ Once the official data is adjusted to compensate, it becomes clear that:-

For Inward Investment in the UK:-

- The EU share of all earnings in the UK from FDI is overstated by 75%
- 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 18%
- The Rest of the World (excluding the EU and the USA) share of all earnings in the UK from FDI is understated by 70%

As a Destination for UK FDI Overseas

- The EU share of the UK's worldwide earnings from overseas ("outward") investment is overstated by 54%
- The Dutch share of the UK's worldwide earnings from overseas investment is overstated 15-fold
- The US share of the UK's worldwide earnings from overseas investment is understated by 20%
- The Rest of the World (excluding the EU and the USA) share of the UK's worldwide earnings from overseas investment is understated by 17%

The real (post-adjustment) geographical pattern of British FDI flows is as follows (note the low position of Japan in Table 1):-

Table 1: Main Inward Investors into the UK

*Measured by Earnings⁴ AFTER adjustment
for the Netherlands Distortion*

By Region	USA & Canada	55%
	EU 14	25%
	Rest of World	<u>20%</u>
		100%
By Country	USA	52%
	France	9%
	Switzerland	4%
	Austr. + New Zeal.	4%
	Canada	3%
	Germany	3%
	Eire	2%
	Sweden	2%
	Japan	2%
	Belgium/Lux	2%

Table 2: Main Recipients of UK Investment Overseas

*Measured by Earnings⁴ AFTER adjustment
for the Netherlands Distortion*

By Region	USA & Canada	36%
	EU 14	24%
	Rest of World	<u>40%</u>
		100%
By Country	USA	33%
	Austr. + New Zeal.	7%
	Eire	4%
	France	4%
	Belgium/Lux	4%
	Germany	4%
	Hong Kong	4%
	Switzerland	3%
	Singapore	3%
	Canada	3%

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 2002: Business Monitor MA4*: February 2004: ONS:
www.statistics.gov.uk
3. "EU 14": the fourteen European Union countries comprising the 13 Continental members plus Eire.
4. "Earnings": aggregated (cumulative) earnings 1993-2002 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 ultimate 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 profits, dividends, interest and 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 56 per cent of all EU 14 FDI earnings in the UK.

For UK outward investment overseas the unadjusted ONS data appear to show that the Netherlands accounted for 49 per cent of the total earnings arising from UK FDI in the whole of EU 14.

It is highly implausible, to say the least, that the unadjusted ONS data reflect the real levels of UK 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 those other countries' recorded shares of total inward and outward FDI in respect of the UK. (Similar results are found if GDPs are used instead of population.)

Ten-year aggregates of earnings are used 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 direct investments made in, and by, the UK since at least the 18th Century until now.

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

Table 3 shows that, over the ten-year period 1993-2002 inclusive:-

- The cumulative earnings attributed to EU 14 inward investment in the UK have been overstated by £27.5 billion
- The cumulative earnings attributed to UK outward investment into EU 14 have been overstated by £41.2 billion

Table 3: Cumulative Earnings, 1993-2002 Inclusive: £ billions
On Inward Investment into the UK

Country/Region	Recorded by ONS	%	"Real" after adjustment for the Netherlands Distortion	%	Over (Under) Recording: Recorded less "Real"
EU 14	64.0	44	36.5	25	27.5
USA	62.3	43	76.2	52	(13.9)
Rest of World	19.3	13	32.9	23	(13.6)
World	145.6	100	145.6	100	-
Netherlands	35.7	25	1.8	1	33.9
<i>On UK Outward Investment</i>					
EU 14	118.0	37	76.8	24	41.2
USA	89.0	28	107.0	33	(18.0)
Rest of World	115.6	36	138.8	43	(23.2)
World	322.6	100	322.6	100	-
Netherlands	57.5	18	3.9	1	53.6