

Services are taking an increasing part of inward EU FDI

Paolo Passerini

Foreign direct investment (FDI) statistics give information on one of the major aspects of globalisation. Unlike traditional cross border trade in goods and services, FDI (for definition see page 7) reflects the objectives of establishing a more strategic and long term engagement in a particular market. Eurostat maintains an FDI database which contains harmonised and thus comparable data on inward and outward FDI positions, flows and income for the European Union, its Member States and major FDI partners.

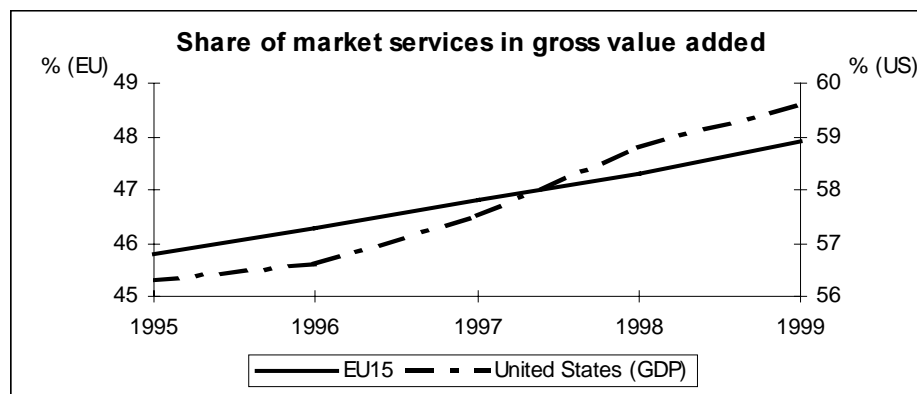
The last two decades of economic development have been characterised by a slow but steady displacement of economic activity from traditional industrial production towards services activities. The revolution in the information technology and the emergence of electronic markets is expected to strengthen this development further in the years ahead. The evolution will require wide-ranging adaptations and reforms of education systems and labour markets in order to exploit the possibilities these new areas represent.

During the Lisbon summit in March 2000 the leaders of the European Union agreed on a new strategy to strengthen employment, economic reforms and social cohesion as part of a knowledge-based economy. The aim of this strategy is to transform EU into the most competitive and dynamic knowledge-based economy in the world within the next decade¹. One of several ways of achieving this will be to attract foreign capital and know-how in order to assure the competitiveness and innovation of the European services branches.

This report looks at the profile and characteristics of the European Services sectors and more specifically their ability to attract foreign direct investments.

Services behind an increasing part of gross value added

Figures for gross value added for the 1995-99 period illustrate the above-mentioned trend. For the 15 EU Member States the share of market services in gross value added increased from 45.8% in 1995 to 48.1% in 1999. In the United States, where market services play a larger role (partly due to a traditionally smaller public sector) this movement was even more pronounced².



Source for United States: Bureau of economic analysis (US department of Commerce)

Statistics in focus

ECONOMY AND FINANCE

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BALANCE OF PAYMENTS

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¹ Presidency conclusions, Lisbon European Council 23 and 24 March 2000.

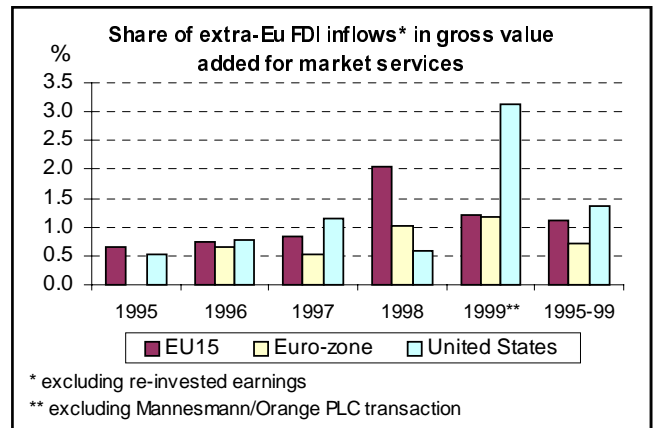
² The share of total services (including public services) is with around 68% comparable between EU and the United States.

Trend in total market services for selected variables

	Annual growth rates in EU15 for services (%)			
	Gross value added at basic prices	Import	FDI inflows from extra-EU15	FDI inflows from Intra-EU15
1996	5.9	11.7	18.8	0.5
1997	6.4	16.3	15.4	26.5
1998	5.9	4.1	175.0	85.2
1999	5.9	7.3	-38.5	0.3

The overall move towards services activities was accompanied by a similar strong rise in direct investments going into services during recent years³. The growth in incoming FDI to EU Services generally outperformed the trends which could be seen in the statistics for gross value added or trade.

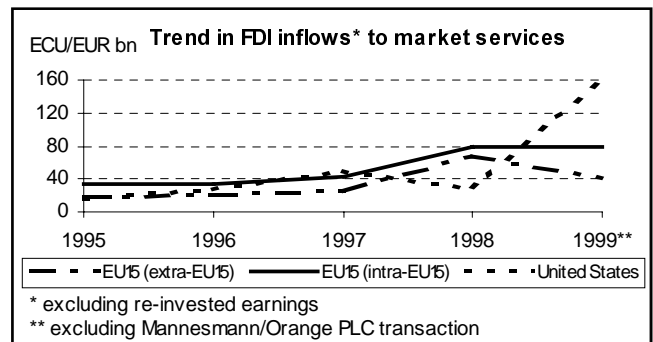
It is worth noticing that the economic importance (measured as FDI per gross value added) of FDI in Services was more apparent in the 15 EU Member States compared to the 11 Member States in the euro-zone area (1995 not available). Seen over the whole 1995-99 period, the ratio in the 15 EU Member States was slightly inferior to comparable figures in the United States.



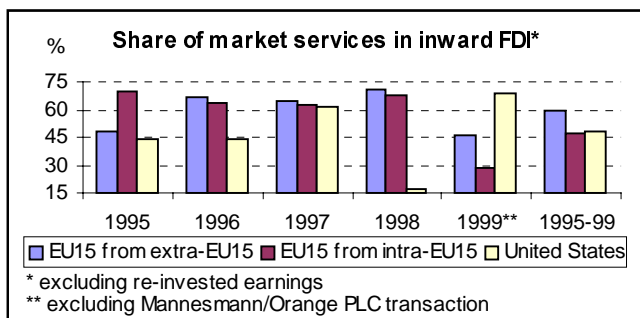
Source for United States: Bureau of economic analysis (US department of Commerce)

The EU is leading in telecommunication while the United States is ahead in computer services

The share of total in-going FDI which was canalized into market services was significantly higher in the EU compared to the United States during the 1995-99 period. Though market services generated only about 46% of gross value added in the European Union in that period, they attracted nearly 60% of all incoming FDI from extra-EU countries. In the United States the situation was opposite: Here market services were behind nearly 60% of total gross value added but they received about 48% of all incoming FDI. The figures also illustrate that apart from 1995 the intra-EU15 FDI (FDI made between the EU Member States) were characterised by a relatively lower focus on Services.



Source for United States: Bureau of economic analysis (US department of Commerce)



Source for United States: Bureau of economic analysis (US department of Commerce)

Figures suggest that it was intra-EU15 flows which were most constant over the 1995-99 period. The level of incoming FDI into market Services in the European Union and the United States was comparable during that period, with 1999 being an exception.

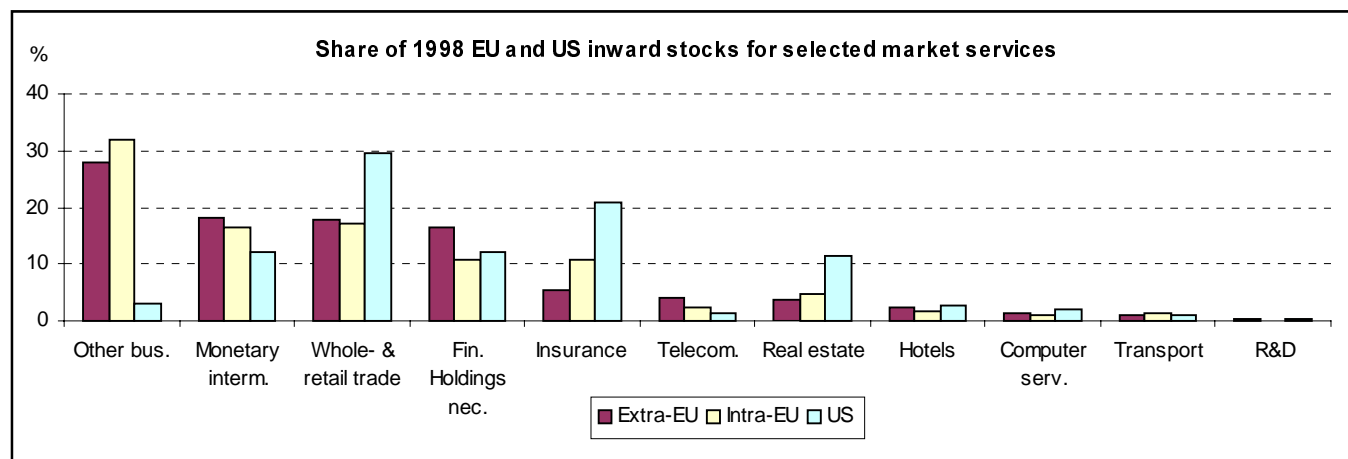
It is characteristic at the same time that the 15 EU Member States recorded an almost similar amount of FDI transactions among each other as the Union as a whole received from extra-EU countries.

³ Throughout this report the Mannesmann/Orange PLC merger in 1999 has been excluded from the figures (see box page 7).

A further look at the profile of FDI stocks in services reveals that the EU telecommunication sector attracts a relatively higher share of FDI in market services than their US counterparts. The United States on the other hand appears to have a higher share in the very important group of computer services which among others contain hardware and software consultancy, including the huge market potential in internet facilities.

The amount of FDI going directly into innovation (Research & Development) remained both in the European Union and in the United States at a very moderate level.

The United States on the other hand appeared to be way behind Europe as regards in-going FDI to the group of other businesses which group among others: legal services, advertising, recruitment, security and industrial cleaning.



FDI inflows to market services from extra- and intra-EU countries (ECU/EUR mio)

	Flows from Extra-EU15					Flows from Intra-EU15				
	1995	1996	1997	1998	1999*	1995	1996	1997	1998	1999*
Services	17 881	21 250	24 522	67 428	26 661	33 657	33 811	42 783	79 245	79 491
of which										
Trade & repair	2 242	5 091	4 020	3 624	4 137	4 546	6 202	8 356	6 765	7 454
Hotels	127	457	663	546	994	1 385	907	198	614	414
Transport & Communication	36	538	2 610	8 447	43	1 090	823	4 404	4 533	10 658
of which										
Telecommunication	126	-39	586	6 468	-1 734	999	-207	3 509	2 422	8 712
Transport	51	392	1 160	424	603	-2	804	332	205	568
Financial intermediation	5 596	8 836	5 308	33 034	21 102	14 962	10 651	10 623	40 309	29 363
of which										
Monetary intermediation	1 432	1 176	3 874	3 792	2 189	3 699	2 818	2 446	17 295	5 368
Insurance companies	-994	1 894	1 397	2 485	10 829	2 955	1 271	276	13 446	4 754
Financial holdings nec	5 161	5 710	-143	26 765	12 891	8 258	6 113	7 343	10 774	13 970
Real estate & business. act	9 879	6 327	11 920	21 777	15 221	11 675	15 228	19 202	27 025	31 601
of which										
Real estate	1 622	846	200	849	-254	1 509	694	1 767	2 920	3 373
Computer activities	419	162	326	1 894	1 725	531	232	1 191	700	1 770
Research and devel.	327	532	-90	764	255	577	40	-826	257	175
Other business activities	7 451	4 482	11 502	17 741	12 676	8 939	13 081	16 508	21 842	22 804

* excluding Mannesmann/Orange PLC transaction

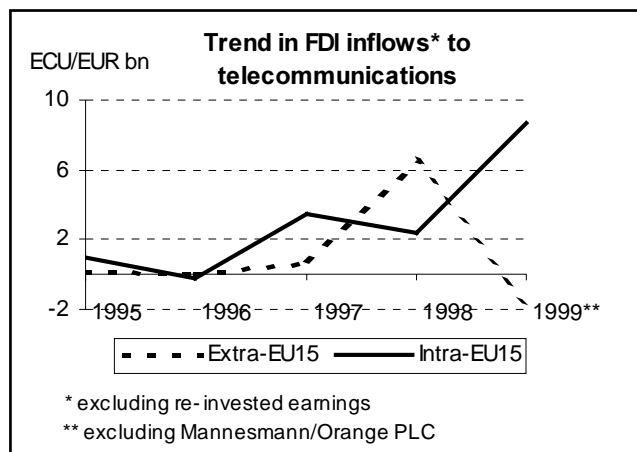
The growth in FDI into EU market services in recent years first of all came from other Member States

Based on its share in FDI stocks, Services historically have played a slightly less dominant role in the profile of in-going FDI. By the end of 1998 only 55.9% of all extra-EU assets were located in a service sector while this number was about 61.1% for intra-EU owned FDI capital.

During the 1995-98 period, however, the share of cumulated FDI flows to the market services represented approximately two thirds of all incoming FDI in the EU Member States. This increased weight on market services characterised most of the sectors and concerned both extra- and intra- FDI. Major exceptions were the Trade & Repair as well as the Hotel services which received relatively less FDI during recent years (see table below).

Most concerned was the Trade & Repair branch which hosted 9.7% of all FDI stocks in the EU by the end of 1998 but only received 7.4% of incoming flows between 1995 and 1998.

Direct investments into the very important telecommunication sector first of all came from other EU Member States. Over the 1995-99 period the intra-EU FDI generally outperformed investments from outside the EU area, which especially in 1999 appeared subdued.



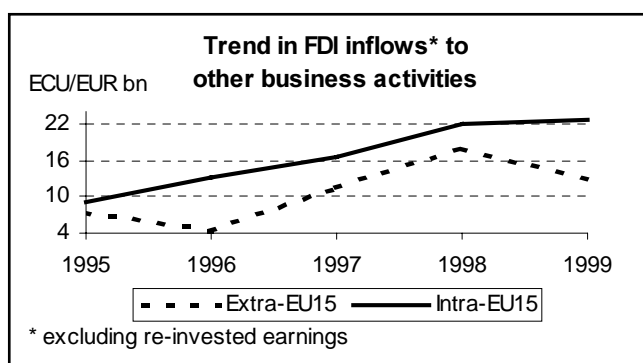
Trend in direct investments in market services 1995-98

	Extra-EU15 (%)			Intra-EU15 (%)		
	Share in 1998 FDI stocks	Share in cumulated 1995-98 flows	Trend	Share in 1998 FDI stocks	Share in cumulated 1995-98 flows	Trend
Services	54.4	64.9	↗	60.1	66.1	↗
of which						
Trade & repair	9.7	7.4	↘	10.3	9.0	↘
Hotels	1.2	0.4	↗	1.0	1.1	→
Transport & Communication	3.6	5.8	↗	2.6	3.8	↗
of which						
Telecommunication	2.2	3.5	↗	1.3	2.3	↗
Transport	0.6	1.0	↗	0.8	0.5	↘
Financial intermediation	21.7	26.1	↗	23.4	26.7	↗
of which						
Monetary intermediation	9.8	5.1	↘	9.9	9.2	→
Insurance activities	2.9	2.4	↘	6.5	6.3	→
Financial holdings nec	8.9	18.6	↗	6.4	11.3	↗
Real estate & business activ.	18.2	24.7	↗	22.8	25.5	↗
of which						
Real estate	2.0	1.7	↘	2.7	2.4	→
Computer activities	0.7	1.4	↗	0.6	0.9	↗
Research and development	0.1	0.8	↗	0.1	0.0	↘
Other business activities	15.1	20.4	↗	19.1	21.1	↗

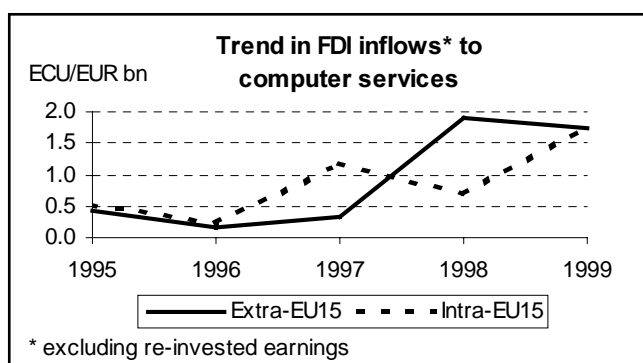
- ↘ Share of stocks > 10% higher than share of flows
- Difference between share of flows and share of stocks < 10%
- ↗ Share of flows > 10% higher than share of stocks

The figures also illustrate that the consolidation of the European telecommunication sector which could be seen in recent years first of all was driven by FDI commitments from other EU Member States and to a lesser extent by extra-EU participation⁴.

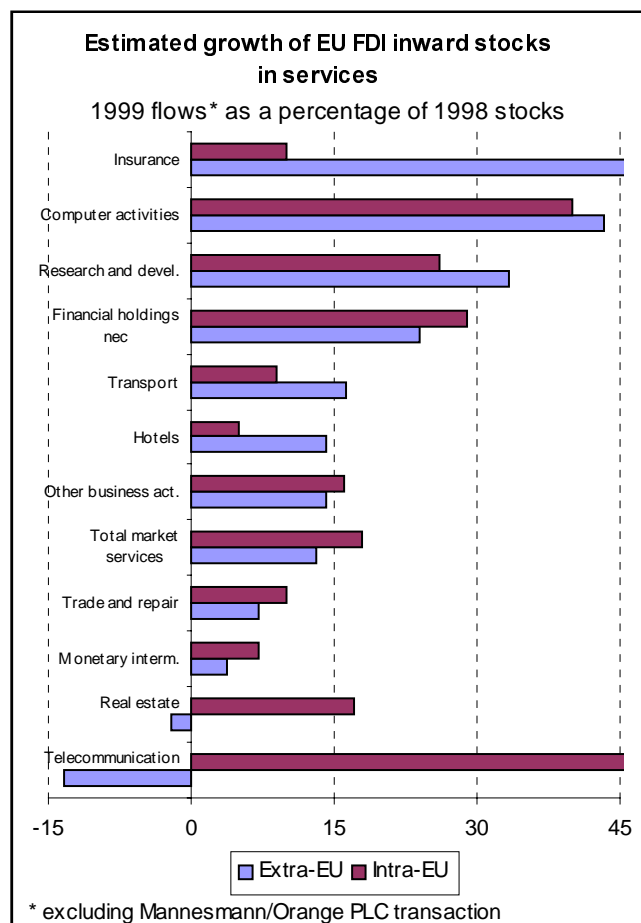
Financial intermediation, which traditionally has hosted the biggest chunk of FDI capital, received about 26.1% of cumulated 1995-98 FDI flows from extra-EU countries and an almost similar share of intra-EU FDI. However, it is the group which includes financial holdings companies which have recorded the strongest growth in recent years. More than 71% of FDI in financial intermediation from extra-EU countries were made in this sector during the 1995-98 period.



Real estate & business activities is the other group which holds important shares of FDI in services. This is at the same time the area in which major developments are expected to take place in the coming years due to the very knowledge-intensive content of these activities. Dominant here were the activities included under other business activities, which received around 20% of cumulated inflows to the European Union between 1995 and 1998. The main part of direct investments here came from within the European Union.



Computer services and research and development are still minor markets for direct investors but they were subject to intensive growth during recent years. Computer services only held 0.7% of all incoming FDI stocks from extra-EU partners by the end of 1998, but received 1.4% of cumulated 1995-98 flows to the European Union. For research and development the intensified focus was even more pronounced: the sector hosted 0.1% of FDI positions from extra-EU partners but received 0.8% of recent years' FDI inflows.



This trend seems to have continued in 1999 where computer services recorded the most expansive FDI of all services activities. Direct investments in the EU computer services amounted to about 38% of the recorded FDI positions by the end of 1998, and this expansion took place in extra- as well as intra- FDI transactions.

FDI in research and development expanded strongly in 1999 with expansion rates reaching 32% of total recorded FDI for extra-EU FDI.

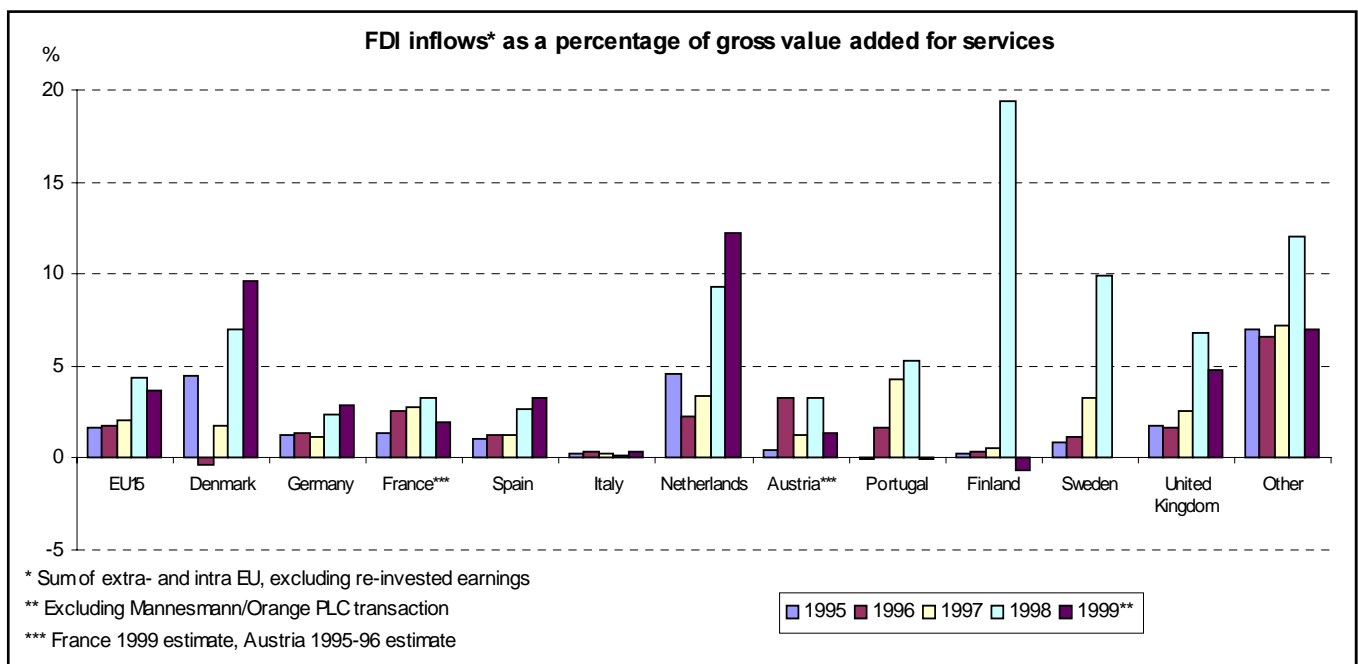
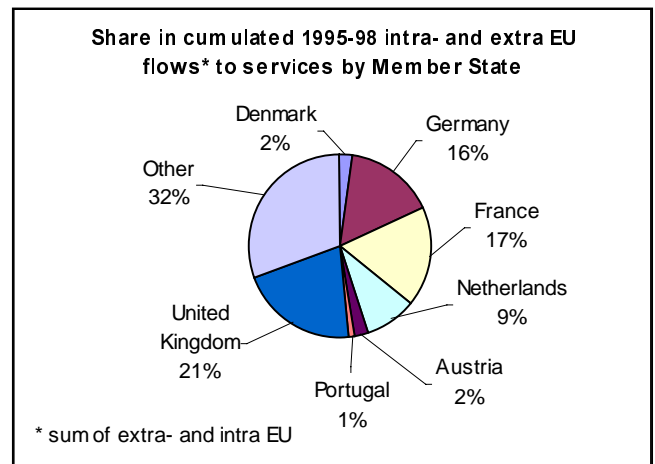
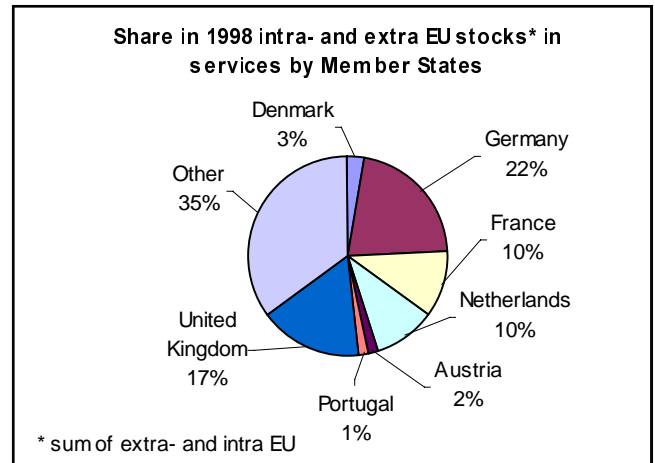
⁴ Nearly 100% of cumulated 1995-1999 extra-EU FDI in the European telecommunication sector originated from the United States (excluding Mannesmann/Orange PLC transaction).

FDI in services appears to be economically most important in the smaller EU Member States

The German economy is the main market for incoming FDI in services in the European Union. By the end of 1998 Germany hosted 22% of all FDI stocks in services in the EU, followed by the United Kingdom which had taken up 17% and France and the Netherlands which each held 10%.

Measured as its share of total gross value added, however, direct investments in German services appear far less important and reached typically only 2-3% during the 1995-99 period. Germany thereby falls below the EU average which settled between 3 and 4 percent during that period. In Spain or France, the share of FDI to gross value added remained also inferior to the average EU numbers during that period. In Italy FDI in market services were almost absent during that period.

The breakdown by Member States furthermore shows that it is in the smaller Member States that direct investments in services appear to have had the strongest economic importance. Most significant were FDI in the Netherlands, Denmark or Sweden where they typically reached between 5 and 12 percent of gross value added during recent years. FDI in the British services also appear to have been significant during that period. The group of "Other Member States" (Belgium/Luxembourg presumably represents an important part) recorded a particular large direct investments in market services during the period.

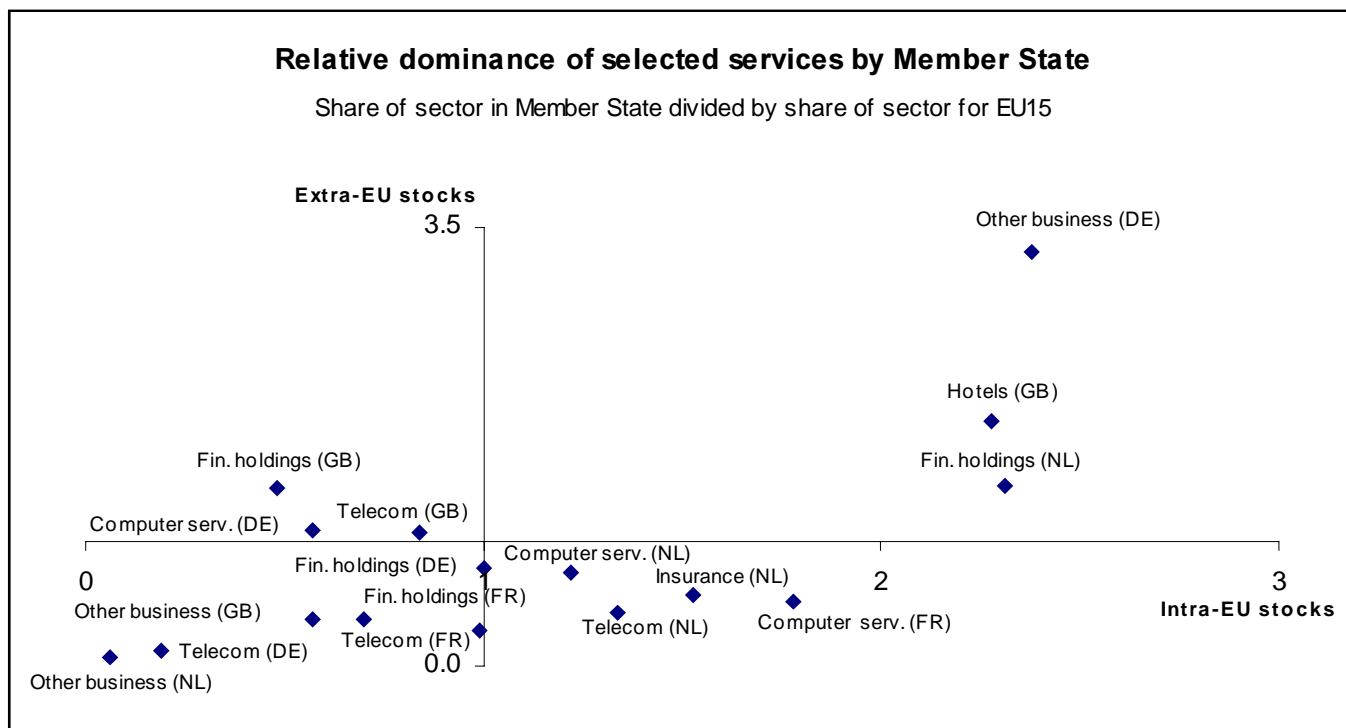


A breakdown of the different service activities by Member State discloses a number of particularities in the distribution of FDI in services among EU Member States. There is a tendency that direct investments in the telecommunication and to a lesser extent computer services were concentrated in the smaller Member States.

Especially direct investments from extra-EU partners seem to be under-represented in telecommunications in France, Germany and the Netherlands, whereas

the Danish market on the other hand appears to have offered a very special environment for telecommunication activities. FDI here have been hugely over-represented (falls outside the scatter) compared to other EU Member States.

FDI in the group of other market services was especially concentrated in the German market where it was more than 3 times as concentrated as in the EU as a whole.



THE MANNESMANN/ORANGE PLC MERGER

In 1999 the German telecommunication giant Mannesmann bought the British tele-operator Orange. This take-over implied two Balance of payments transactions. Deal 1 involved Mannesmann acquiring 100% of UK company Orange PLC for a press reported 19546 million GBP. As Orange PLC was already 50% owned by a Hong Kong parent company, Deal 2 was a matching disposal for approximately half the 19546 million GBP deal value due to Hong Kong. In this report this huge deal has been excluded from the figures in 1999 as its impact on extra-EU inflows is believed to be more of technical than of economic nature.

➤ ESSENTIAL INFORMATION – METHODOLOGICAL NOTES

Foreign direct investment (FDI) is the category of international investment that reflects the objective of obtaining a lasting interest by a resident entity in one economy in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise, and a significant degree of influence by the investor on the management of the enterprise. Formally defined, a direct investment enterprise is an un-incorporated or incorporated enterprise in which a direct investor owns 10% or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an un-incorporated enterprise).

FDI flows and positions: Through direct investment flows, an investor builds up a foreign direct investment position that features on his balance sheet. This FDI position (sometimes called FDI stock) differs from the accumulated flows because of revaluation (changes in prices or exchange rates, and other adjustments like re-scheduling or cancellation of loans, debt forgiveness or debt-equity swaps).

Further information:

➤ Reference publications

Title EU Foreign Direct Investment Yearbook 2000. Analytical aspects.
Detailed tables on CD-ROM - Data 1992-1999
Catalogue No KS-AN-01-001-EN-C Price EUR 50

➤ Databases

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