

Foreign Direct Investment in Spain: holding firm despite (or because of) the crisis

William Chislett | Associate Researcher at the Elcano Royal Institute and author of three books on Spain published by the Institute.

Theme

Spain continues to draw significant levels of foreign direct investment (FDI), despite (or because of) the crisis. Reforms are making FDI in the country more attractive.

Summary

Gross investment, excluding Special Purpose Entities and thus the productive part of FDI, was €13.4 billion in 2012, down from €23.6 billion in 2011, but higher than the €12.2 billion of 2010. The motor industry, close to 90% of whose production is exported, has attracted some €2.5 billion of future investments. Spain slipped to 44th position in the World Bank's 2012 Ease of Doing Business index. However, the index does not reflect the government's reforms in various areas, which have not yet fed fully through into the economy and have the potential to enhance the country's attractiveness.

Analysis

Background

Foreign direct investment (FDI) has long played a prominent role in the Spanish economy, particularly since the 1959 Stabilisation Plan, which put an end to the policy of autarky that followed the 1936-39 Civil War and began to open up the economy. The inward FDI stock stood at US\$634.5 billion at the end of 2011, up from US\$65.9 billion in 1990 (see Figure 1). Among the world's 15 largest economies, Spain's FDI stock in GDP terms (42.1%) is higher than the US's, France's, Germany's and Italy's (see Figure 2). FDI inflows have ranged from a high of 26.4% of gross fixed capital formation in 2000, when the economy was in the middle of a long boom period, to a low of 3% of GDP in 2009, when the economy entered its five-year recession which is not expected to end until the last quarter of this year or 2014. The number of foreign affiliates in Spain was 14,457 in 2010 (latest available UNCTAD figure, more than Italy, see Figure 3). According to some estimates, there were 16,476 affiliates in Spain at the beginning of 2013 with more than 50% of the capital held by foreigners and 18,977 with more than 10%.

Figure 1. Inward FDI stocks by selected countries (US\$ billion), 1990 2011

	1990	1995	2000	2005	2011
France	97.8	237.4	390.9	888.9	963.7
Germany	111.2	165.9	271.6	476.0	698.2
Italy	59.9	65.3	122.5	237.4	332.6
Spain	65.9	110.2	156.3	384.5	634.5
UK	203.9	199.7	438.6	840.6	1,198.8
US	539.6	1,005.7	2,783.2	2,817.9	3,509.3

Source: World Investment Report 2012, UNCTAD.

Figure 2. Inward stock of FDI (% of GDP), 1990 2011

	1990	1995	2000	2005	2011
France	7.8	15.1	29.4	41.5	34.7
Germany	6.5	6.6	14.4	18.8	20.0
Italy	5.3	5.8	11.2	13.4	15.2
Spain	12.7	18.5	26.9	34.0	42.1
UK	20.1	17.3	29.7	36.9	49.8
US	9.3	13.6	27.9	22.3	23.2

Source: World Investment Report 2012, UNCTAD.

Figure 3. Number of parent corporations and foreign affiliates by country, 2010 (1)

	Parent corporations	Foreign affiliates
France	3,222	20,548
Germany	8,346	19,229
Italy	2,758	14,426
Spain	2,407	14,457
UK	7,398	45,466

(1) The number of parent companies/foreign affiliates in the economy shown, as defined by that economy. In some cases data may include counts of establishments.

Source: World Investment Report 2012, UNCTAD.

Inward FDI surged after Spain joined the European Economic Community (EEC) in 1986; at times it seemed as if the country was up for sale. Liberalisation opened up opportunities for foreign companies in a country with a sizeable domestic market, growth potential and the possibilities of using Spain as a platform for exports. These factors assumed as much if not more importance than wage levels, where the gap relative to the then EEC-15 had been narrowing fast until devaluations in 1992 and 1993 began to restore competitiveness. In 1993 Spain's hourly wages in the manufacturing sector were 93% higher than in 1985, compared with an average rise for the EEC of 52%.

The motor industry, the world's 12th largest in 2012 and in a good year Spain's main single export at around 20% of total merchandise exports, has been entirely owned by

multinationals since 1986 when Seat –founded in 1950 with Fiat’s assistance– was sold to Volkswagen (see Figure 4). Multinationals are also strong in cement (Portland and Lafarge Asland) –an industry in the doldrums because of the collapse of the property sector–, electrical appliances (Sony, Philips and Electrolux), electronic components (Siemens and Robert Bosch), electronics (Philips and Honeywell), information technology (IBM and HP) and some consumer products (Unilever and Procter & Gamble). Barclays, Citibank and Deutsche Bank have retail networks, but their share of the market is small. The foreign presence in insurance (Allianz, Axa, Aviva and Generali) is larger than in banking. The French Auchan (known in Spain as Alcampo) and Carrefour groups led a revolution in Spanish retailing, opening hypermarkets that lured customers away from traditional corner shops. The annual turnover of the foreign affiliates in Spain is around €400 billion (38% of GDP) and they employ more than 1.2 million people (7% of workers in employment).

Figure 4. Top 15 vehicle producers, 2012 (millions of units)

Million units		Million units	
1. China	19.27	9. Thailand	2.48
2. US	10.32	10. Canada	2.46
3. Japan	9.94	11. Russia	2.23
4. Germany	5.64	12. Spain	1.97
5. South Korea	4.55	13. France	1.96
6. India	4.14	14. UK	1.57
7. Brazil	3.34	15. Czech Republic	1.17
8. Mexico	3.00		

Source: Anfac.

The relative importance of inward FDI, however, is not as large as the aforementioned figures would seem to suggest. Spain was ranked 57th out of 79 countries in the UNCTAD FDI Contribution Index (see Figure 5) –introduced in the 2012 World Investment Report–, which ranks economies on the basis of the significance of FDI and foreign affiliates in their economy, in terms of value added, employment, wages, tax receipts, exports, research and development (R&D) expenditures, and capital formation (eg, the share of employment in foreign affiliates in total formal employment in each country, and so forth). These variables, over and above FDI’s share of GDP or the number of affiliates, are among the most important indicators of the economic impact of FDI. Spain’s low position could be because the index is calculated on the basis of figures for 2009, when the Spanish economy was in a deep recession and reforms had not been put in place.

Figure 5. FDI contribution index, rankings and indicator quartiles, 2009 (quartile rankings for shares of each indicator in economy totals)

	Value added	Employ.	Exports	Tax Rev.	Wages & sal.	R&D spending	Capital expen.	FDI/inwa. stock/GDP
1. Hungary	1	1	1	1	1	1	1	1
15. UK	2	1	3	2	2	1	2	2
30. Germany	3	2	3	4	1	1	2	4
32. Italy	3	3	3	2	2	1	3	4
39. France	3	2	2	3	2	3	3	3
57. Spain	3	3	3	4	2	2	3	2
70. US	4	3	2	4	4	4	3	4

Source: World Investment Report 2012, UNCTAD.

The business climate

The results of the 2012 barometer of the business climate in Spain, conducted among more than 250 foreign companies by Invest in Spain,¹ the government agency created in 2005 to attract, promote and maintain FDI, and the IESE business school, were broadly similar to those obtained in 2011.²

There was a small fall in the assessment (from an average score of 2.9 out of 5 to 2.7). This barometer, however, does not reflect the impact of the reforms undertaken last year, which are expected to be reflected in the 2013 barometer.

The areas rated the highest are infrastructure, quality of life and human capital and the main areas identified for improvement are the labour market, financing by banks and innovation. Other areas of concern are language skills and the bureaucratic burden of running a company.

Spain was ranked 44th out of 185 countries in the 2013 Ease of Doing Business Index, part of an annual report published by the World Bank, down from 38th position in 2007 before the crisis. The rankings are benchmarked to June 2012 and so do not reflect the government's reforms. There has been a marked improvement in the maximum number of days which the law says are needed to satisfy the requirements to start a business – to 28 in 2012 from 47 in 2005–. This is still far more days than Germany (15) and France (7), however. Nevertheless, companies are often up and running in less than 28 days.

¹ See <http://www.investinspain.org/>.

² See http://www.investinspain.org/icex/cda/controller/interes/0,5464,5322992_6275456_6299039_4634506,00.html

Figure 6. Ease of Doing Business Index: Spain

Ease of...	2012 rank (1)	2007 rank (2)	2006 rank (3)
Doing business (overall)	44	38	39
Starting a business	136	118	108
Dealing with construction permits (4)	38	46	48
Registering property	57	42	41
Getting credit	53	13	12
Protecting investors	100	83	81
Paying taxes	34	93	91
Trading across borders	39	47	43
Enforcing contracts	64	55	59
Resolving insolvency (5)	20	17	15

(1) Out of 185 countries.

(2) Out of 178 countries.

(3) Out of 175 countries.

(4) Called dealing with licences in the 2007 and 2006 reports.

(5) Called closing a business in the 2007 and 2006 reports.

Source: Doing Business reports, World Bank.

Spain compares well in some of the components of the index with countries such as France, Germany and the UK (see Figure 7).

Figure 7. Ease of Doing Business Index: Comparison between Spain and Other Countries

Ease of...	Ahead of...	Behind...
Starting a business	Czech Republic, Greece	UK, France, Germany, Italy
Dealing with construction permits	France, Netherlands, Italy	Germany, UK, Norway, Estonia
Registering property	UK, Germany, France	Czech Repub. Italy, Netherlands
Getting credit	Belgium, Norway, Italy	Ireland, Israel, Germany, Croatia
Protecting investors	Slovakia, Netherlands	Slovenia, Italy, France
Paying taxes	France, Poland, Italy	UK, Switzerland, Netherlands
Trading across borders	Poland, Italy	Germany, France, Ireland
Enforcing contracts	Slovakia, Israel, Italy	France, Portugal, Poland
Resolving insolvency	Portugal, Italy, France	Belgium, Ireland, Germany

Source: Doing Business 2013, World Bank.

The impact of the crisis and of reforms on FDI

The average annual gross FDI inflow between 2008 and 2012, including Special Purpose Entities (SPEs), which are mainly financial holding companies, foreign-owned, and principally engaged in cross-border financial transactions, with no or negligible local activity, was €25.5 billion, compared with a pre-crisis average for 2003-07 of €21.3 billion. The annual average net FDI (ie, investment less divestment) in 2008-12 of €18.3 billion, also including SPEs, was also higher than in 2003-07 (€13.1 billion). Divestment in 2012 was four times higher than in 2011 at €20.8 billion, almost €17 billion of it due to SPEs. Excluding SPEs, divestment in 2012 was €3.8 billion, virtually unchanged since 2011.

However, gross investment, excluding SPEs and thus the most productive part of FDI, in 2012 was €13.4 billion, down from €23.6 billion in 2011, but higher than the €12.2 billion in 2010. The amount spent in 2012 on setting up companies was €883 million (€160 million in 2011), capital increases took up €10.5 billion (€21.4 billion) and acquisitions €2.0 billion (€1.9 billion).

The main investor in Spain in 2012 was the US, whose gross investment of €2.2 billion excluding SPEs was 53% higher than in 2011 (see Figure 8). The largest slice of total gross investment in 2012 (7.6%) excluding SPEs went to aluminium production, followed by electricity output (6.6%), credit activities (6.3%) and the manufacturing of electrical and electronic components for vehicles (4.9%).

Figure 8. Gross investment in Spain excluding SPEs by the main ultimate investing countries (% of total)

	2012	2011
US	16.4	6.1
Netherlands	16.0	6.4
Luxembourg	12.8	8.2
Germany	10.2	4.9
UK	6.7	28.7
France	5.1	24.3

Source: Investment Registry.

While domestic demand remains depressed (its contribution to GDP growth has been negative since 2008), external demand has been positive, preventing the recession and job losses from being even deeper. Exports of goods were €223 billion in 2012, 25% more than pre-crisis levels (2006-2007), and this was not achieved as a result of a currency devaluation, unlike in the past. As a euro country, Spain cannot devalue. Foodstuffs, semi-finished goods, capital goods and automotive products – areas where foreign companies have varying degrees of presence – accounted for 75% of exports (see Figure 9).

Figure 9. Goods exports (€ billion)

	2000-05 average	2006-07 average	2012
Automotive sector	29	33	31
Capital goods	29	39	44
Semi-finished goods	31	46	57
Foodstuffs	20	24	34
Energy products	5	8	16
Other	23	28	41
Total	138	178	223

Despite the weak domestic market (the number of new cars sold in 2012 fell by 13.4% to 699,589, the lowest figure since 1986), investments in car producers in Spain of more than €2.5 billion over the next few years have been announced. Exports of vehicles have held up relatively well, despite the depressed European market (see Figure 10).

Figure 10. Output and exports of cars and industrial vehicles (million), 2007-12

	Output	Exports	Exports as % of total output
2007	2.88	2.38	82.6
2008	2.54	2.18	85.8
2009	2.17	1.88	86.7
2010	2.38	2.97	87.0
2011	2.37	2.12	89.4
2012	1.97	1.72	87.4

Source: Anfac.

The Spanish car industry has long been very competitive. The same cannot be said for the economy as a whole. There are signs, however, that this is changing, as a result of the austerity measures, greater productivity and the decline in real wages. Nominal salaries rose by an annual average of 5.2% in 2008-11, before the labour market reforms and despite the recession, and by 0.3% in 2012. Spain is the only euro zone country whose unit labour costs dropped (by 4%) between the last quarter of 2007 and the same period of 2012 (see Figure 11).

Figure 11. Change in unit labour costs 4Q07-4Q12 (%) – Total economy

	% change
France	11.5
Germany	12.9
Italy	10.1
Portugal	0.1
Spain	-4.1
Euro area	9.6

Source: OECD.

Another significant improvement is in the current account deficit, which fell by nine percentage points of GDP over the last five years to below 1% of GDP in 2012 and this year will be in surplus for the first time in more than a decade.³ The private and public sectors, however, remain heavily indebted. Gross public debt reached 84% of GDP in 2012, more than double the level in 2007.

The labour market is more flexible as a result of the government's reforms in 2012. Spain's staggeringly high unemployment rate of 26% (more than double the euro zone

³ The March 2013 report on Spain by the Consejo Empresarial para la Competitividad (Business Council for Competitiveness) explains in detail the changes and reforms and the direction in which the economy should move (<http://www.iefamiliar.com/web/en/consejo2.html>).

average) is due not only to an unsustainable economic model, excessively based on the construction and property sectors, but to higher firing costs and the dual and dysfunctional labour market split between insiders (those in a privileged situation on permanent contracts) and outsiders (those on fixed-term contracts). Before the reforms, which lower firing costs and give companies greater flexibility to negotiate their own deals with their workers and not be bound by centralised sector-wide collective bargaining agreements, Spain was ranked, according to the OECD, 20th out of 23 countries in terms of the costs of firing for objective (justified) reasons. A new permanent contract has also been introduced for companies employing fewer than 50 people (95% of total employment in Spain).

The government has also moved to halt the fragmentation of the internal market. A draft law to guarantee the unity of the market, approved by the Cabinet in January and expected to come into force this year, enables companies to operate throughout Spain with a single licence. Companies no longer need permits to operate in each of the country's 17 autonomous regions, as could happen in the past. Different regions imposed different rules on companies, deterring them from expanding outside their home market. In one of the more absurd examples cited as a reason for the new measure, a company making slot machines had to manufacture 17 different models in order to meet the requirements of each regional government.

Lastly, the banking sector is slowly recovering from its near collapse. The number of commercial and savings banks has shrunk from 50 in 2009 to 16.

As a result of these and other factors, Spain is among the 10 most 'promising' countries to receive inward FDI in 2012-14, according to the survey in the latest (2012) World Investment Report published by UNCTAD.

The Consejo Empresarial para la Competitividad (Business Council for Competitiveness) lists Spain's main attractions for FDI as:

- One of the best infrastructure networks in Europe.
 - A world leading telecommunications sector.
 - Energy costs to the industrial sector below the European average.
 - A corporate tax system that has made significant strides in becoming less complex and lowering tax burdens compared with the rest of Europe.
 - Overall costs between 10% and 30% lower than Spain's main European partners, with skilled labour costs some 25% to 40% lower.
 - Productivity levels rising two to three times faster than that of Spain's main European partners. Spain's GDP/employee will outstrip that of Germany and Italy.
-

The Council has identified six sectors which are particularly promising for foreign investment as they are not only internationally competitive but have proved to be more resilient to the crisis than others, thanks to their growing international focus, innovation and highly-qualified personnel in a context of lower labour costs compared to competitors. They are: the automotive sector, biotechnology, food and agriculture, ICTs and audiovisual, aerospace and machine-tooling (see Figures 12 and 13). These added-value sectors generate around 35% of exports and employ more than 2 million people.

Figure 12. Key sectors of the Spanish economy

	Sectors with growth potential (1)	Total sectors
Turnover/employee (€)	182,000	103,000
Annual average growth over last 2 years (turnover, %)	2.9	-0.6
Exports/output (%)	36	29

(1) Automotive sector, biotechnology, food and agriculture, ICTs and audiovisual, aerospace and machine-tooling.

Source: Business Council for Competitiveness based on Spanish accounting figures, the INE business survey, the Ministry of Agriculture, Food and the Environment, ICEX and information provided by sector associations (ANFAC, SERNAUTO, ASEBIO, AFM). Latest available data: 2011.

Figure 13. International positioning of key Spanish sectors

	EU	World
Food and agriculture	4 th in food exports	8 th in food exports
	1 st in canned food production	2 nd in canned food production
Automotive	1 st in industrial vehicle production 3 rd in parts and equipment	
Machine-tooling	4 th in exports	10 th in exports
Biotechnology	5 th in scientific output	10 th in scientific output
Aerospace	5 th in production and employment	

Source: Business Council for Competitiveness.

Conclusion

Economic growth, as of 2014 and after a long recession, and the impact of reforms have the potential to enhance Spain's attractiveness for foreign companies.