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Icelandic foreign direct investment

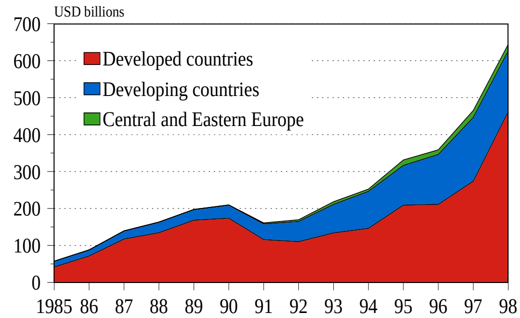
Icelandic foreign direct investment stock at the end of 1998 amounted to 23.5 billion krónur, having increased by 3.9 billion krónur from the previous year. Outward investment flow during the year was a record 5 billion krónur. Some 40% of this stock is in enterprises located in the USA and the UK, and around three-quarters in fisheries and related operations. Iceland's earnings from foreign direct investments has been low in recent years. Icelanders have made less foreign direct investment than most other OECD countries.

International financial flows

One of the characteristic features driving internationalization in recent years has been the large growth and increased mobility of capital. Financial flows may be divided into three categories: lending, portfolio investment and direct investment. In 1997 these financial flows amounted to USD 2,600 billion worldwide. The diagram below shows the development of foreign direct investment (FDI) over the period 1985-1998, based on figures for inflows to host countries. Statistics for inflows and outflows do not match, but the former are considered more reliable.[2] The inflow amounted to USD 644 billion in 1998, an increase of 39% from the previous year. Developed countries account for the bulk of this investment, with USD 462 billion. Some USD 165 billion went to developing countries and USD 17 billion to Central and Eastern Europe. Widespread corporate mergers and acquisitions in developed countries in 1998 are one of the main explanations for this greater flow. The total value involved in the 32 largest mergers and acquisitions was in excess of USD 3 billion. In 1998 the inflow of FDI to developing countries slowed down, following steady increases over the period 1985-1997. This turnaround may be attributed to recent economic problems encountered by certain developing countries.

Chart 1

Foreign direct investment inflows



Source: UNCTAD.

Many reasons underlie global growth in FDI, to some extent interrelated. The main reasons are liberalization of intra-national and international trade, technical innovation, lower transportation and communications costs, greater competition, abolition of monopolies and increased privatization. Furthermore, the economies of most OECD countries have been in good shape.

Icelandic FDI stock

Historically, Icelandic FDI has largely been made by the large seafood sales and marketing companies.

1. The author is employed in the statistics department of the Central Bank of Iceland.
2. Deviations may be explained by differences in various countries' data collection methodologies. Classification, valuation, scope and selection of the timing of transactions may differ. Furthermore, some transactions or trades may not be recorded.

Box 1 - Definition of terms

An investment of 10% or more in an enterprise is considered to be a direct investment, while a smaller share is classified as portfolio investment. The terms domestic and foreign are defined on the basis of domicile, not citizenship. Thus a party domiciled in Iceland is considered to be Icelandic.

FDI stock in an enterprise comprises the share in the book value of its equity and the net lending position with respect to it. A parent company granting a loan to a subsidiary in another country increases its stock in that company in the same way as if a share contribution had been involved. Both current and long-term loans are included in the net lending position.

The book value of equity can be increased by a share contribution or reinvestment of earnings. Reinvestment of earnings is retained earnings after payment of dividends.

Transportation and fisheries companies have also made some foreign investments. In addition, Icelandic companies have made small-scale investments in foreign companies linked to the fisheries sector. Recently the share of investment in other sectors has been increasing. Through FDI, companies aim to gain access to resources, increase efficiency and gain access to markets. The bulk of Icelandic FDI may be explained as market access strategies, while around one-tenth of the stock may be attributed to access to natural resources. The Icelandic companies investing most in other countries are Eimskip hf. (The Iceland Steamship Company Ltd.), Íslenskar sjávarafurðir hf. (Iceland Seafood International plc), Marel hf., Samherji hf., Sölusamband íslenskra fiskframleiðenda hf. (SIF - The Union of Icelandic Fish Producers Ltd.) and Sölumiðstöð hraðfrystihúsanna hf. (Iceland Freezing Plants Corporation plc). These six companies accounted for 80% of total stock at the end of 1998.

Icelandic FDI has been increasing steadily over the period 1988-1998. Stock at year-end 1998 amounted to 23.5 billion kr., having increased by 3.9 billion kr. during the course of the year, or 20%. At the same time, 13.8 billion kr. of the stock was accounted for by lending and 9.7 billion kr. by equity, a ratio which has remained fairly steady in the past few years. Table 1 shows the sectors in which Icelandic FDI has been made, based on classifications by international agencies. At the end of 1998 some 74% of Icelandic FDI stock was in the fisheries sector (sales and marketing, processing and fishing).

Table 1. Icelandic FDI stock, by industrial sector

Billion kr.

At respective year-end prices	*1995*	*1996*	*1997*	*1998*
Food production	6.5	6.4	8.2	8.7
Trade and commerce	2.2	3.3	3.5	5.9
Transportation	1.1	2.9	3.3	2.8
Fishing	0.8	1.9	2.4	2.7
Other	1.1	1.6	2.2	3.4
Total	*11.7*	*16.1*	*19.6*	*23.5*

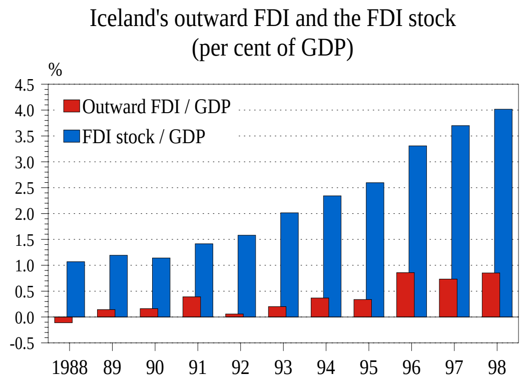
Table 2. Icelandic FDI stock, by host country

Billion kr.

At respective year-end prices	*1995*	*1996*	*1997*	*1998*
USA	4.6	4.2	4.9	5.1
UK	2.9	4.1	4.0	4.7
France	1.3	1.9	1.8	2.4
Germany	0.7	1.3	1.4	1.8
Netherlands	0.7	2.2	2.1	1.4
Spain	0.3	0.3	0.7	1.8
Other European countries	0.8	1.1	2.9	3.8
Other American countries	0.4	0.8	1.5	1.9
Other countries	0.1	0.2	0.3	0.5
Total	*11.7*	*16.1*	*19.6*	*23.5*

In comparison with most other OECD nations, Iceland has a low FDI stock. At the end of 1998 it was equivalent to 4% of GDP. Among the other Nordic countries this figure is over 20% and in some OECD countries it exceeds 50%. In terms of individual host countries, Icelanders have invested the most in the USA and the UK, although the relative importance of the stock there has diminished in recent years. Over the period 1988-1991 it was in the range 80-94%, while at the end of 1998 it had dropped to 42%. Iceland's FDI host countries and main countries for merchandise exports show some correspondence which is apparently becoming more marked. At the end of 1998, 72 Icelandic parties had made direct investments in 141 foreign enterprises, located in 33 countries and 5 continents. Most of the companies are subsidiaries, or 101. Subsidiaries account for around 88% of the stock. There are 38 associates, accounting for 11%.

Chart 2



Icelandic FDI

FDI flows can take the form of equity investments, reinvestment of earnings and intra-company loans. Investment during a given year need not necessarily be reflected in the difference between the stock at the beginning and end of that year. The reason is that the aggregates for these positions are stated on an accounts basis but the flow aggregates on a payments basis. Table 3 shows that considerable fluctuations take place in the composition of Icelandic FDI flows from one year to the next.

In 1998 FDI outward flows amounted to around 5 billion kr., which means that Iceland's share in the global FDI flows that year was 0.01%.[3] As a proportion of GDP, Icelandic FDI flows in 1998 were 0.9%. Over the period 1988-1998 the average figure was 0.4%, but it was 0.2% over the period 1988-1995. Iceland's figure for FDI outward flows is below the annual OECD average, which was equivalent to 2.4% of GDP in 1996-1998.

In 1998 Icelandic parties made foreign direct investments in 43 enterprises, involving equity investments to the tune of 2.2 billion kr., and sold shares in 4 enterprises for 0.5 billion kr. Equity investments may be divided into ongoing investments and new investments, the latter category involving 26 investments to the value 1.3 billion kr. Most investments were on a small scale. In only 8 cases was the sum invested larger than 0.1 billion kr., and the largest investment was 0.2 billion kr. Intra-company loans amounted to 3.1 billion kr., and reinvestment of earnings 0.2 billion kr.

Table 3. Icelandic FDI outward flows

Billion kr.

At respective year-end prices	*1995*	*1996*	*1997*	*1998*
Net equity transactions	0.3	0.6	2.5	1.7
Reinvestment	-0.2	0.4	0.1	0.2
Intra-company loans	1.4	3.2	1.3	3.1
Total	*1.5*	*4.2*	*3.9*	*5.0*

According to the methodology used by international agencies, investments in real estate, vessels and land should be included in FDI. This, however, is not done in the present survey of Icelandic FDI. It is known that Icelandic parties own real estate in other countries such as business premises, embassies, diplomatic residences and apartments. The value of these properties may be estimated at several billion kr., of which real estate owned by the Icelandic state would amount to 1-1.5 billion kr. The Icelandic state owns holdings in foreign enterprises and agencies which were valued at 2.6 billion kr. in the treasury accounts for 1998. Other foreign assets owned by Icelanders are bank deposits and securities. The total security stock was estimated at 65 billion kr. at the end of 1998.[4]

The figures presented here for Icelandic FDI are not exhaustive. The figure for total FDI by individuals is some way from being complete, because of the difficulty in acquiring information about private finances. Information is also lacking about certain transactions involving investments by Icelandic parties in fisheries companies in other countries, for example when fishing vessels are sold in return for payment in the form of shares in the foreign company. Furthermore, it has proved problematic to acquire information about holding companies established by Icelanders in countries where these enjoy a more favourable environment than in Iceland.

Icelandic earnings from FDI

Table 4 shows Icelandic earnings from FDI. These earnings can take three forms: dividend payments, reinvestment of earnings and net interest earnings on

3. Provisional figures suggest a similar level of outward FDI flows in 1999. Iceland's portfolio investment was 28 billion kr. in 1999, compared with 19 billion kr. the year before.

4. According to provisional figures, the stock of Icelandic portfolio investments abroad stood at 132 billion kr. at the end of 1999.

Box 2 - Determinants of foreign direct investment

A company's decision to invest in another country is the result of a complex process. Such a decision may be reached when the needs of the foreign company match the advantages of the host country. There are two classes of determinants for the selection of a host country for FDI: factors on which the government has an impact and characteristic or inherent factors of the economy. The former case includes the government's policy towards foreign investment and the business environment created by it. Examples are economic, administrative and social stability, taxation policy, international agreements, privatization, trade policy, etc. Examples of factors linked to the economy itself can be seen in the table below. Essentially, companies make foreign direct investments in order to gain access to necessary factors of production and assets, to increase efficiency through access to inexpensive factors of production, and to gain access to markets. The table presents these factors in more detail.

Motives behind FDI	*Main economic determinants of FDI in host countries*
Resource/asset-seeking	• Raw materials, energy • Low-cost unskilled labour • Skilled labour • Technological, innovatory and other created assets (e.g. brand names) including those embodied in individuals, firms and clusters • Physical infrastructure (ports, roads, power, telecommunication)
Efficiency-seeking	• Cost of resources and assets, adjusted for productivity for labour resources • Cost of other inputs • International cooperation, e.g. EEA/NAFTA
Market-seeking	• Size of market and per capita income • Market growth • Access to regional and global markets • Country-specific consumer preferences • Structure of markets

Source: World Investment Report 1998.

account of intra-company loans. In 1998 these earnings amounted to 0.5 billion kr., representing a return on the stock of 2.3%. Only 52 subsidiaries and 12 associates in which Icelanders had invested in other countries generated a profit in 1998. Average earnings over the period 1988-1998 amounted to 0.2 billion kr. per year and the return on the stock over the same period was 2.3%.[5] It is interesting to note that the level of profitability is not higher. It turns out to be less than half that of FDI by foreign parties in Iceland. In other words, foreign parties benefit more by FDI in Iceland than Icelanders do from their own FDI. This is an interesting fact, given the frequent complaints from Iceland's business community about shortcomings in the Icelandic operating environment compared with those in many other countries. Various explanations may be offered for this low level of profitability. The most apparent one is that Icelanders are investing in low-profitability sectors and in environments which they have difficulty in mastering.

5. By comparison, in 1997 and 1998 the annual return on the foreign portfolio investment owned by Icelandic pension funds amounted to 15%.

Table 4. Iceland's earnings revenues from FDI

Billion kr.

At respective year-end prices	*1995*	*1996*	*1997*	*1998*
Dividends	0.1	0.0	0.1	0.1
Reinvestment	-0.2	0.4	0.0	0.2
Net interest payments	0.0	0.1	0.2	0.2
Total	*-0.1*	*0.5*	*0.3*	*0.5*

Sources:

UNCTAD, World Investment Report 1998.
UNCTAD, World Investment Report 1999.
IMF Committee on BOP statistics, annual report 1998.